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Supreme Court, U.S.
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NO.

IN THE

# Supreme Court of The United States

OCTOBER TERM, 1991

NL INDUSTRIES, INC.

*Petitioner,*

v.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC.
AND S.A. HOLDITCH & ASSOCIATES, INC.,

*Respondents.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. May punitive damages for intentional postpetition torts committed by a debtor in possession constitute allowable administrative expenses under 11 U.S.C. § 503(b)?

2. Did the dismissal of a claim solely on the basis that it was not allowable as a first priority administrative expense, and without any opportunity for the claimant to avail itself of the Bankruptcy Code's procedures for alternate treatment of its claim, deprive the claimant of property without due process of law in violation of the Fifth Amendment of the United States Constitution?

3. Under *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145 (1968), may the decision of a contractually designated arbiter be binding where the arbiter has a prior undisclosed business relationship with one of the parties?

## LIST OF PARTIES

The parties to the proceedings below were petitioners NL Industries, Inc. and respondents GHR Energy Corporation, Southern States Exploration, Inc. and S.A. Holditch & Associates, Inc.

## RULE 29.1 LISTING

The parent corporation of petitioner NL Industries, Inc. is Valhi, Inc. NL Industries, Inc. has no subsidiaries other than its two wholly-owned subsidiaries, Kronos, Inc. and Rheox, Inc. Tremont Corporation also has a financial interest in the outcome of this litigation.

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner NL Industries, Inc. respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered on September 10, 1991.

## OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 940 F.2d 957 and is reprinted in the appendix (A). The opinions of the United States District Court for the Southern District of Texas, Houston Division, have not been reported and have been reprinted in the appendices (B, D).

## JURISDICTION

Jurisdiction of this Court to review the judgment of the Fifth Circuit is invoked under 28 U.S.C. § 1254(1).

By order of June 3, 1991, the Fifth Circuit affirmed in part and reversed in part the judgment of the district court, and

remanded for further proceedings. 932 F.2d 422. On June 17, 1991, NL timely filed a petition for rehearing and a suggestion for rehearing en banc. By unreported order of July 5, 1991, reprinted in the appendix (F), the Fifth Circuit denied the petition for rehearing and the suggestion for rehearing en banc. The Fifth Circuit then issued a "corrected opinion" on July 26, 1991. 934 F.2d 580. On September 10, 1991, the Fifth Circuit withdrew its "corrected" opinion and issued a third opinion. 940 F.2d 957. On September 16, 1991, this Court granted an extension of time to file this petition to November 2, 1991. This petition has been timely filed pursuant to Supreme Court Rule 13.2.

## STATUTES INVOLVED

This case involves consideration of 28 U.S.C. § 959(b), which requires debtors in possession to operate in accordance with valid state law, and 11 U.S.C. § 503(b)(1)(A), which requires that the actual and necessary costs and expenses of preserving a debtor's estate shall be allowed as administrative expenses. This case also involves the due process clause of the Fifth Amendment to the United States Constitution and 28 U.S.C. §§ 157(d) and 158, which govern the requirements for a district court to regain original subject matter or appellate jurisdiction over bankruptcy matters referred to the bankruptcy court. Also relevant, but not directly in issue, are 11 U.S.C. § 507(a)(1), which accords first priority to allowed administrative expenses; 11 U.S.C. § 1129(a)(9)(A), which mandates that, in order to be confirmed, a plan of reorganization must provide for payment in full of allowable administrative expenses; and 11 U.S.C. § 1141(d)(1)(A), which governs the dischargeability of debts upon confirmation of a plan of reorganization. As required by Supreme Court Rule 14.1(f), the text of these statutes and rules is set forth in the appendix (J).

## STATEMENT OF THE CASE

The Fifth Circuit held that punitive damages based on postpetition torts by a debtor in possession could not constitute an allowable administrative expense in a Chapter 11 reorganization proceeding. The Fifth Circuit's ruling conflicts both in reasoning and result with decisions by this Court and several other circuits and undermines the Bankruptcy Code's ability to effectuate successful reorganization.

In 1983, GHR Energy Corporation and Southern States Exploration, Inc. (collectively "GHR") filed voluntary petitions for reorganization under Chapter 11. In 1985, as part of GHR's reorganization and with express authorization of the bankruptcy court, GHR and NL entered into an agreement for the workover of 10 existing GHR gas wells to increase their productivity (the "Agreement"). R. 216, Ex. 1. In 1986, NL sued GHR in federal district court as permitted by 28 U.S.C. § 959(a), alleging contract and tort claims, including fraud, arising out of GHR's performance of the Agreement. R. 1114. NL claimed over $15 million in actual damages and sought punitive damages. NL later amended to add S.A. Holditch & Associates, Inc., as a defendant. R. 821. Holditch had been appointed to review the workover procedures under the Agreement.

In bankruptcy court, NL filed its request for payment of disputed administrative expenses in a document titled "Proof of Claim." NL's request for payment was filed expressly pursuant to 11 U.S.C. §§ 503 and 507, which govern claims for administrative expenses. R. 216, Ex. 16. NL's district court complaint demanding both actual and punitive damages was attached to and incorporated in NL's request for payment of administrative expenses. The bankruptcy court subsequently entered an order classifying NL's claims as disputed administrative expenses.

GHR's plan of reorganization provided for payment in full of allowable administrative expenses, including disputed administrative expenses such as NL's tort claims once they were liquidated, whether such expenses were allowed by the bankruptcy court before or after confirmation. R. 216, Ex. 20, p. 6-7, 53; 216, Ex. 19, p. 373 (App. G, I). Without these provisions, GHR's Plan would not have been confirmable. 11 U.S.C. § 1129(a)(9)(A).

To obtain confirmation, GHR repeatedly and unequivocally reaffirmed the effect of the Plan with regard to NL's claims in particular, stating that NL was "absolutely, totally 100% protected," R. 216 Ex. 28, p. 81, that GHR could "pay all allowed administrative expenses regardless of their size, as required by the Bankruptcy Code," R. 216, Ex. 24, p. 8, and that "[a]ll administrative expenses that are allowed will be paid in full, whether they are allowed before or after confirmation. *The Plan could not do any more to satisfy these expenses.*" R. 216, Ex. 24, p. 2 (emphasis in original). The Plan made no exception to full payment for the punitive damages portion of NL's claims. GHR's disclosure statement specifically described NL's claims, as provided for in the Plan, as including punitive damages. R. 216, Ex. 19, p. 373 (App. G).

The bankruptcy court's order confirming GHR's Plan expressly found that it provided for payment in full of all allowable administrative expenses under 11 U.S.C. § 507(a)(1), specifically including NL's claims being litigated in district court. R. 216, Ex. 18, p. 6-7. The bankruptcy court also expressly retained jurisdiction over determination of the allowance of claims. R. 216, Ex. 18 p. 13; Ex. 20, p. 187-189 (App. H, I). No one appealed confirmation of GHR's Plan.

On October 13, 1989, more than two years after confirmation, GHR moved for partial summary judgment on NL's district court complaint, arguing, in part, that punitive damages are not allowable administrative expenses as a matter of law. Holditch also moved for summary judgment. Both GHR and Holditch argued that Holditch's status as an "arbiter" under the Agreement insulated them from any liability based on negligence. Holditch, however, had an extensive prior business relationship with GHR which had not been disclosed to NL before it entered into the Agreement designating Holditch as an arbiter. R. 216, Ex. 2, ¶ 8; Ex. 15, ¶ 11.

The district court granted summary judgment in favor of both GHR and Holditch. The Fifth Circuit affirmed as to Holditch and reversed in part as to GHR.

The Fifth Circuit's holding that punitive damages based on postpetition torts by a debtor in possession cannot be an administrative expense conflicts with two decisions of this Court as well as decisions of at least the First, Fourth and Ninth Circuits and presents an important issue of bankruptcy law regarding Chapter 11 of the Bankruptcy Code and 28 U.S.C. § 959(b). The Fifth Circuit's holding also deprives NL of property without due process of law. The issue of whether punitive damages can constitute administrative expenses affects only the *priority* of NL's claim. By dismissing the claim in its entirety, the Fifth Circuit precluded NL from access to any procedural mechanism provided by the Bankruptcy Code for assertion and classification of its claims in bankruptcy. By even addressing the question of the classification of NL's claim at all the Fifth Circuit usurped the bankruptcy court's jurisdiction, undermined the terms of a final unappealable confirmation order which should have been res judicata and violated the

Bankruptcy Code's procedural mechanism for appeals of bankruptcy court orders.

The Fifth Circuit also held that Holditch's status as an arbiter insulated GHR and Holditch from any liability for negligence despite a contrary and controlling decision by this Court.

## REASONS FOR GRANTING THE WRIT

### I. The Fifth Circuit's Holding That Punitive Damages Are Not Administrative Expenses Conflicts With Decisions Of This Court And With Decisions Of Other Federal Appellate Courts And Presents A Question Important To Administration Of The Bankruptcy Laws That Should Be Addressed By This Court.

This case is governed by the principles established in *Reading Co.* v. *Brown*, 391 U.S. 471 (1968), and *Boteler* v. *Ingels*, 308 U.S. 57 (1939). *Reading* v. *Brown* stands for the proposition that postpetition tort claims are recoverable in full as administrative expenses in a Chapter 11 proceeding. 391 U.S. at 483, 485. *Boteler* v. *Ingels* establishes that a bankrupt's estate is liable for monetary penalties imposed by state law for wrongful postpetition conduct. 308 U.S. at 60-61. These two cases compliment each other, and both their holdings and underlying policies are directly applicable here.

*Reading* v. *Brown* held that "damages resulting from the negligence of a receiver acting within the scope of his authority as receiver give rise to 'actual and necessary costs' of a Chapter XI arrangement" and therefore constitute administrative expenses entitled to first priority. 391 U.S. at 485. *See* 11 U.S.C. §§ 503(b), 507(a)(1). This holding extends to all postpetition torts committed by a debtor in possession. This Court declined to distinguish among different torts,

held that all postpetition tort claims "should be potentially payable *in full*" and repeated that "the rule of *full recovery* for torts is demonstrably sounder." 391 U.S. at 483 (emphasis added).

Two fundamental Bankruptcy Code policies underlie *Reading* v. *Brown*. The first is fairness. Existing creditors hope that by postponement of their claims, they will, through rehabilitation, eventually recover a larger portion than they would in an immediate liquidation. *Id.* at 478. Fairness requires that those injured by continued operation of the business should recover ahead of those for whose benefit the continued operation of the insolvent business is allowed. *Id.* at 482-83. This principle comports with the historical conception of fairness: tort claims arising during a reorganization period have long been given administrative expense priority. *Id.* at 483 n.10. This Court considered various alternatives to administrative expense treatment and concluded that "none of these [alternatives] has case support, and all seem to us unsatisfactory." *Id.* at 479.

Fairness considerations apply with even more force here than to the purely negligence-based claims in *Reading* v. *Brown*. Unlike *Reading* v. *Brown*, existing creditors not only received a hypothetical benefit from GHR's continued operation but an actual benefit from NL's involvement in the reorganization. By funding $15 million for the workovers of 10 GHR gas wells, NL increased the productivity of those wells, thus increasing GHR's cash flow to the benefit of GHR and its existing creditors. It would be fundamentally unfair to allow those existing creditors who benefitted from this transaction to recover ahead of NL which was injured by the same transaction. *See Hofer* v. *Lavender*, 679 S.W.2d 470, 474-75 (Tex. 1984) (punitive damages are necessary to

compensate a tort victim for otherwise unrecoverable losses such as attorney's fees and intangible litigation costs).

The second Bankruptcy Code policy underlying *Reading* v. *Brown* is to encourage prudent and responsible operations by a debtor in possession to protect both existing creditors and postpetition claimants. In *Reading* v. *Brown*, the receiver had failed to maintain insurance. This Court pointed out that making claims potentially payable in full would encourage a receiver or a debtor in possession to obtain insurance in adequate amounts for the protection of the estate, its creditors and potential tort victims. 391 U.S. at 483. This observation illustrates an economic fact: reducing a debtor in possession's potential financial responsibility reduces its *operational* level of responsibility as well; it will be encouraged to take greater — and perhaps ill-advised — risks because the costs of failure have been reduced while the rewards of success remain the same or even increase. The Fifth's Circuit's decision encourages irresponsible, even fraudulent, behavior by eliminating the most serious consequences of such behavior.

*Boteler* v. *Ingels* serves a related policy: that of enforcing the debtor's compliance with state laws. In *Boteler* v. *Ingels*, this Court held that a bankrupt's estate is liable for postpetition civil tax penalties imposed by state law. 308 U.S. at 61. *Boteler* v. *Ingels* recognizes that entities operating under protection of the bankruptcy laws are not "immune from State laws or valid measures for their enforcement." *Id.* at 60-61. 28 U.S.C. § 959(b) explicitly subjects debtors in possession to valid state laws.

The Fifth Circuit's decision that punitive damages are not recoverable as administrative expenses under 11 U.S.C.

§ 503(b) conflicts with the decisions of other circuits applying *Reading* v. *Brown* and *Boteler* v. *Ingels*. The sole rationale for the Fifth Circuit's holding precluding punitive damages was that "we can conceive of no way in which allowing punitive damages would benefit GHR's estate." 940 F.2d at 966. This "no benefit" argument has been specifically rejected by several circuits considering claims based on postpetition misconduct of the debtor in possession.

The Ninth Circuit, stating that it is "well established that damages for a post-petition tort become an administrative expense," applied *Reading* v. *Brown* to allow a libel claim that included punitive damages. *In re Dennis Ponte, Inc.*, 61 B.R. 296, 298 (Bankr. 9th Cir. 1986). The Ninth Circuit not only rejected the result reached by the Fifth Circuit, it also rejected the Fifth Circuit's reasoning by recognizing that benefit to the estate is not an issue in cases involving postpetition misconduct by a debtor in possession. The Ninth Circuit held that *Reading* v. *Brown* "covers a broad range of non-contractual claims *which are not attended by benefit to the estate." Id.* (emphasis added). *Accord In re E.A. Nord Co. Inc.*, 78 B.R. 289, 290-91 (Bankr. W.D. Wash. 1987) (rejecting the "no benefit" analysis and holding that monetary sanctions against a debtor in possession for frivolous claims litigation were administrative expenses).

In *In re Charlesbank Laundry, Inc.*, 755 F.2d 200, 201-02 (1st Cir. 1985), the First Circuit held that a civil fine imposed for violation of a temporary injunction was allowable as an administrative expense. Like the Ninth Circuit, the First Circuit specifically rejected the "no benefit" argument. Quoting *Reading* v. *Brown*, the First Circuit held that it is "'more natural and just' to allow those injured by operation of a business during arrangement to 'recover ahead of . . . those for whose benefit the business is carried

on.'" *Id.* at 202. *Charlesbank Laundry* also pointed out that deliberate acts of the debtor present an even more compelling case for priority than did the facts in *Reading* v. *Brown*. *Id.* at 203. *Accord Carter-Wallace, Inc.* v. *Davis-Edwards Pharmacal Corp.*, 443 F.2d 867, 874 (2d Cir. 1971) (Friendly J.) The same reasoning applies to the intentional torts alleged by NL against GHR.

The Fourth Circuit's application of *Boteler* v. *Ingels* is similar. In *United States Dept. of Interior* v. *Elliott*, 761 F.2d 168, 169 (4th Cir. 1985), the Fourth Circuit held that a monetary penalty based on postpetition environmental misconduct was allowable as an administrative expense of preserving the estate. Both *Elliott* and *Boteler* v. *Ingels* recognize that debtors in possession are not exempt from civil penalties based on postpetition misconduct. The allowance of penalties as administrative expenses serves important societal interests: in *Elliott*, effecting compliance with environmental laws, 761 F.2d at 172 n.6; in *Boteler* v. *Ingels*, enforcing state tax laws, 308 U.S. at 61; in *E.A. Nord*, deterring frivolous litigation, 78 B.R. 290-91; and here, enforcing state fraud laws. The genesis of the penalty is not an issue. As *Elliott* held, the bankruptcy estate is subject to "*all* postpetition penalty claims, regardless of their type and regardless of whether they are incurred by the trustee or by the debtor in possession." 761 F.2d at 171 (emphasis in original). *Boteler* v. *Ingels* and *Elliott* apply here, and the same result should have been reached.

The Fifth Circuit's decision also subverts important policies central to the administration of the Bankruptcy Code. In addition to the policies served by *Reading* v. *Brown, Boteler* v. *Ingels* and their progeny, a principal statutory objective of Chapter 11 is rehabilitation of insolvent businesses. As *Reading* v. *Brown* makes clear, the concept of benefitting or

preserving the estate includes "the larger objective ... of operating the debtor's business with a view of rehabilitating it." 391 U.S. at 475. *Accord Carter-Wallace*, 443 F.2d at 874. Viewed in this light, the potential allowability of punitive damages in cases arising from postpetition business transactions does benefit the estate. Rehabilitation is impossible to achieve unless suppliers, insurers, lenders and the like conduct business with the debtor in possession. Such transactions are essential to the continued operation of the estate which, in turn, benefits the estate and its creditors. To induce a party to deal with the debtor in possession, that party must be afforded the same rights and remedies available against an entity that is not undergoing reorganization. Any increased risk makes a party more reluctant to deal with the debtor in possession, at a minimum necessitates higher prices to compensate for the increased risk and, consequently, hampers the debtor in possession's ability to reorganize.

These considerations apply forcefully to the facts of this case. NL agreed to deal with a reorganizing debtor in possession and was damaged by intentional torts committed by the debtor in the course of that business transaction. If a party so treated is not allowed full recovery, third parties whose participation is essential to reorganization may be unwilling to deal with the debtor in possession.

The overriding importance of protecting parties in postpetition business transactions with debtors in possession is evidenced by the fact that the Bankruptcy Code, to the extent possible, assures full payment of allowable postpetition administrative expenses under 11 U.S.C. § 503(b). The Code exempts postpetition claims from the automatic stay (*compare* 11 U.S.C. § 362 *with* 28 U.S.C. § 959(a)), affords postpetition administrative expenses first priority (11

U.S.C. § 507(a)(1)), and mandates that a plan shall not be confirmed unless it provides for their full payment (11 U.S.C. § 1129 (a)(9)(A)), thus effectively exempting postpetition administrative expenses from discharge. 11 U.S.C. § 1141(d)(1)(A) (confirmation discharges debts "*except as otherwise provided . . . in the plan or in the order confirming the plan . . .*") (emphasis added). The Fifth Circuit's decision debilitates the policies served by these and other Code provisions by reducing the consequences to debtors of recklessness or fraud, while saddling everyone who does business with a reorganizing debtor with the risks of its unlawful behavior.

Another goal of the Bankruptcy Code is enforcing a debtor in possession's compliance with the law and its obligation of good faith. These obligations balance the operational freedom granted to debtors in possession under 11 U.S.C. § 1107 and protect the jurisdictional integrity of the bankruptcy courts. *Matter of Little Creek Development Co.*, 779 F.2d 1068, 1071-73 (5th Cir. 1986). The recoverability of punitive damages serves this goal by "creat[ing] a strong incentive for vigilance by those in a position 'to guard substantially against the evil to be prevented'." *Pacific Mut. Life Ins. Co.* v. *Haslip*, _____ U.S. _____, 111 S. Ct. 1032, 1041 (1991). By freeing debtors in possession from the threat of punitive damages the Fifth Circuit's ruling undermines this statutory goal, encourages irresponsible and illegal conduct and makes bankruptcy a sanctuary for fraud and other misconduct. Moreover, by undercutting valid state laws designed to deter reprehensible conduct, the Fifth Circuit's decision raises important federalism concerns. *Cf. Kelly* v. *Robinson*, 479 U.S. 36, 47-49 (1986).

Finally, full payment also prompts creditors to monitor the acts of the debtor in possession to insure appropriate

operation of the business and compliance with the law. *Elliott* emphasized the watchdog role of creditors, pointing out that they can neither shield their eyes nor benefit from unlawful conduct by the debtor in possession. 761 F.2d at 171-72.

If the statutory privilege of reorganization is to work to the benefit of creditors, debtors and the economy as a whole, the courts must guard against its use as a sanctuary for corruption. The Fifth Circuit's decision, however, would permit reorganizing entities to abuse the privileges they enjoy by wilfully or recklessly inducing innocent parties to enter fraudulent transactions. Skewing business judgment by removing or reducing risks threatens harm not only to individual interests but to the balanced operation of the Code.

## II. By Dismissing NL's Punitive Damages Claim Solely On The Basis That It Is Not An Allowable Administrative Expense, And By Circumventing The Procedural Protections Of The Bankruptcy Code, The Fifth Circuit's Ruling Deprived NL Of Property Without Due Process Of Law.

Even if the Fifth Circuit were correct in holding that NL cannot recover punitive damages from GHR's estate *as an administrative expense* under 11 U.S.C. § 503(b)(1)(A), only the *priority* of NL's claim would be affected. The administrative expense issue simply concerns whether NL "should be subordinated to, should share equally with, or should collect ahead of those creditors for whose benefit the continued operation of the business . . . was allowed." *Reading* v. *Brown*, 391 U.S. at 478.

If NL's punitive damages claim is not an administrative expense, it nevertheless remains a compensable claim of some type. NL's punitive damages claim against GHR is a species of property protected by the due process clause of the

Fifth Amendment. *Logan* v. *Zimmerman Brush Co.*, 455 U.S. 422, 429 (1982). The bankruptcy laws are subject to the commands of the Fifth Amendment. *United States* v. *Security Indus. Bank*, 459 U.S. 70, 75 (1982); *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445, 451 (1937).

To comply with the dictates of due process, the Bankruptcy Code must provide procedures to achieve "a fair, reasonable, and equitable distribution of [the debtor's] assets," *Kuehner* v. *Irving Trust*, 299 U.S. at 452, and the claimant must have the opportunity to assert its claims so that it may share in that distribution. *City of New York* v. *New York, N.H. & H. R. Co.*, 344 U.S. 293, 296-97 (1953). A postpetition tort claim is "compensable out of the assets of the estate," and if it is not allowed as a first priority administrative expense, there still must be "some means of asserting [the] claim against the business whose operation resulted in the" injury. *Reading* v. *Brown*, 391 U.S. at 478 n.7, 479. Summary dismissal of NL's punitive damages claim deprived NL of any means to assert its claim in bankruptcy court and therefore deprived NL of property without due process.

This unconstitutional deprivation occurred because the Fifth Circuit completely circumvented the Bankruptcy Code's claim classification system, ignored the appellate scheme set up by the Bankruptcy Code and usurped the bankruptcy court's subject matter jurisdiction. By finding that NL's claim for punitive damages was not an "actual, necessary cost of preserving the estate," the Fifth Circuit necessarily determined that NL's claim was not "allowable" as an administrative expense under 11 U.S.C. § 503, which would be entitled to first priority under 11 U.S.C. § 507(a)(1). Neither the district court nor the Fifth Circuit had subject matter jurisdiction to determine the allowability

or priority of claims, nor was the propriety of the bankruptcy court's orders classifying NL's entire claim as an administrative expense properly before either court.

A blanket Order of Reference in the Southern District of Texas, issued pursuant to 28 U.S.C. § 157(a), automatically vested the bankruptcy court with exclusive original subject matter jurisdiction over the GHR bankruptcy. *See In re Engra, Inc.*, 86 B.R. 890, 896 (S.D. Tex. 1988). The allowance or disallowance of a claim such as NL's is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B), and jurisdiction over the adjudication of core proceedings rests in the first instance with the bankruptcy court pursuant to 28 U.S.C. § 157(b)(1).

After the GHR bankruptcy was referred by the district court, there were only two methods by which the district court or the Fifth Circuit could have reacquired jurisdiction. The first is by an appeal to the district court under 28 U.S.C. § 158 of a bankruptcy court order. No one filed a timely appeal of the bankruptcy court's order confirming GHR's Plan, which classified NL's claim as an administrative expense and held that NL's claim did not impact on the feasibility of GHR's Plan. The bankruptcy court's confirmation order therefore became final and unappealable, and neither the district court nor the Fifth Circuit had subject matter jurisdiction to interfere with it. *In re Souza*, 795 F.2d 855, 857 (9th Cir. 1986). The confirmation order is *res judicata* as to all issues that could have been raised under a confirmed plan, including the classification of NL's claim. *Republic Supply Co.* v. *Shoaf*, 815 F.2d 1046, 1047 (5th Cir. 1987). To allow usurpation of the bankruptcy courts' subject matter jurisdiction and alteration of claim priorities long after the time for appeal has passed completely eviscerates the Bankruptcy Code's claim classification system,

undermines the finality of confirmed bankruptcy reorganization plans and vitiates the statutory bankruptcy appellate scheme.

The only other route by which the district court and the Fifth Circuit could have acquired subject matter jurisdiction over the allowability or priority of NL's punitive damages claim as an administrative expense is under 28 U.S.C. § 157(d), which provides that "[t]he district court may withdraw, in whole or in part, any case or proceeding referred [to the bankruptcy court] under this section, on its own motion or on timely motion of any party, for cause shown." GHR never made a § 157(d) motion for withdrawal of reference, however, and the district court never withdrew the reference as to the allowability or priority of claims.

The only withdrawal of the reference was at the behest of NL and did not concern the allowability or priority of its claim. NL initially filed suit in district court under 28 U.S.C. § 959(a). GHR removed the case to bankruptcy court on the basis that adjudication of NL's claims was a core proceeding. R. 1076. The bankruptcy court disagreed. Pursuant to the bankruptcy court's recommendation, the district court reasserted jurisdiction over the suit. R. 806, 807. The district court's order, however, simply returned the suit to its original posture. Only the merits of NL's state law claims were pending in district court under 28 U.S.C. § 959(a). The bankruptcy court expressly retained subject matter jurisdiction over all core bankruptcy proceedings, including determination of the allowance and priority of claims. R. 216, Ex. 18 p. 13; Ex. 20, p. 187-89. (App. H, I).

No legitimate argument can be made that the district court impliedly withdrew the reference on its own motion. First, the district court did not rule on the allowability of

NL's punitive damages claim. Second, any attempted withdrawal by implication would have been ineffective because the district court did not show the required cause for such a withdrawal. *In re Hall, Bayoutree Assoc., Ltd.*, 939 F.2d 802, 805 (9th Cir. 1991). Thus, the district court, and by extension the Fifth Circuit, never acquired subject matter jurisdiction over the allowability or priority of NL's claims.

The "show cause" requirement under § 157(d) mandates that a withdrawal of reference from the bankruptcy court "must be based on a sound, *articulated* foundation." *Holland America Ins. Co.* v. *Succession of Roy*, 777 F.2d 992, 998 (5th Cir. 1985) (emphasis added). The construction of § 157(d) by other courts has shown that Congress designed the show cause requirement to protect a fundamental right of bankruptcy creditors to avail themselves of the unique expertise of the bankruptcy courts. That requirement is not to be treated as a mere formality by a district court. *In re Parklane/Atlanta Joint Venture*, 927 F.2d 532, 536 (11th Cir. 1991); *In re Pruitt*, 910 F.2d 1160, 1168 (3d Cir. 1990). The show cause requirement is substantive. The failure to show cause for withdrawal of the reference as required by § 157(d) precluded the district court and the Fifth Circuit from reacquiring the referred subject matter jurisdiction.

Since neither the district court nor the Fifth Circuit had subject matter jurisdiction, adjudication of the allowability of NL's punitive damages claim as an administrative expense by the Fifth Circuit is void *ab initio*. The result of this void ruling is to preclude NL of any means of asserting its punitive damages claim in GHR's reorganization proceeding thus depriving NL of its claim without due process.

## III. The Fifth Circuit's Holding That GHR And Holditch Are Insulated From Any Liability For Negligence Because The Agreement Designated Holditch As An Arbiter Is In Direct Conflict With *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145 (1968), Because Holditch Had An Extensive Prior Business Relationship With GHR Which Was Not Disclosed To NL.

Separate from the bankruptcy issues, the Fifth Circuit held that, while NL could recover from GHR for fraud, NL could not recover from GHR or Holditch for negligence because the Agreement designated Holditch as an arbiter with regard to the fracture treatment designs involved in the gas well workovers at issue. The Fifth Circuit's ruling directly conflicts with *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145, 147-48 (1968).

Holditch had an extensive prior business relationship with GHR which was not disclosed to NL when it entered into the Agreement with GHR. R. 216, Ex. 10, pp. 8-9, 72. At that time, NL believed that Holditch had been retained to review the fracture treatment designs by GHR's bank creditors or by the bankruptcy court. R. 216, Ex. 2, ¶ 8; Ex. 15, ¶ 11. NL had no knowledge that Holditch had previously done extensive work for GHR. *Id.* NL's evidence in this regard must be taken as true because this is a summary judgment proceeding. *Anderson* v. *Liberty Lobby*, 477 U.S. 242, 255 (1986).

This Court held that an arbiter's decision could not be binding under such circumstances:

> It is true that petitioner does not charge before us that the third arbitrator was actually guilty of fraud or bias in deciding this case, and we have no reason, *apart from the undisclosed business relationship*, to suspect him of

> any improper motives. But neither this arbitrator nor the prime contractor gave to petitioner even an intimation of the close financial relations that had existed between them for a period of years.

*Commonwealth* v. *Continental*, 393 U.S. at 147-48 (emphasis added). Agreeing to arbitration does not suspend the elementary requirements of impartiality taken for granted in every judicial proceeding. *Id.* at 145. *See State* v. *Buckner Const. Co.*, 704 S.W.2d 837, 842 (Tex. App. — Houston [14th Dist.] 1985, writ ref'd n.r.e.) (arbiter's decision may be set aside for implied bad faith or failure to exercise an honest judgment). Certiorari should be granted to review the Fifth Circuit's ruling because it conflicts with *Commonwealth* v. *Continental.*

## CONCLUSION

In depriving Chapter 11 administrative expense claimants of full recovery for postpetition torts the Fifth Circuit has created a conflict not only with *Reading* v. *Brown* and *Boteler* v. *Ingels*, but with the decisions of other circuits applying those cases. The Fifth Circuit fashioned this sweeping revision of bankruptcy law in a misguided effort to benefit the estate. In doing so, it twisted the most fundamental and uniform goals of the Bankruptcy Code away from the sound policies of rehabilitating insolvents and encouraging responsible and lawful business practices, and toward the flawed result of offering sanctuary to the unscrupulous. The Fifth Circuit has sapped the force of valid state laws with which the Bankruptcy Code was never intended to interfere.

The Fifth Circuit's dismissal of NL's punitive damages claim also presents a fundamental denial of due process. The court's ruling that NL's claim is not a priority administrative expense does not justify dismissal, but only reclassification. Moreover, it deprives NL of any means to assert its claim in

bankruptcy court, and it was accomplished without subject matter jurisdiction. Finally, the Fifth Circuit's ruling dismissing NL's negligence claims on the basis that Holditch was an arbiter is in direct conflict with a prior ruling of this Court. NL requests that this Court grant a writ of certiorari to review these rulings of the Fifth Circuit or grant the petition, vacate and remand.

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IN THE

# Supreme Court of The United States

OCTOBER TERM, 1991

NL INDUSTRIES, INC.

*Petitioner,*

v.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC.
AND S.A. HOLDITCH & ASSOCIATES, INC.,

*Respondents.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

## APPENDIX

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## APPENDIX A

NL INDUSTRIES, INC.,

*Plaintiff-Appellant,*

v.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC., and
S.A. HOLDITCH & ASSOCIATES, INC.,

*Defendants-Appellees.*

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No. 90-2235.

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United States Court of Appeals,
Fifth Circuit.

September 10, 1991.

Appeal from the United States District Court for the Southern District of Texas.

Before THORNBERRY, JOLLY AND SMITH,

Circuit Judges.

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THORNBERRY, Circuit Judge:

This court withdraws its earlier opinion reported at 934 F.2d 580, and substitutes the following opinion.

In 1983, GHR Energy Corporation and Southern States Exploration, Inc. (collectively referred to hereinafter as "GHR") filed voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code. As part of GHR's reorganization, NL Industries, Inc. ("NL") agreed to service ten of GHR's gas wells in an attempt to increase their production. The agreement required NL to service the wells using whatever method GHR stipulated but also provided that S.A. Holditch & Associates, Inc. ("Holditch"), an engineering firm, would review GHR's designs. NL agreed to be

paid solely from the revenue produced by the re-worked wells.

NL performed the services that GHR requested, but the wells failed to produce as expected, and NL did not recover its costs. NL sued GHR under a variety of theories, but the pith of its complaint was that GHR used a much riskier and more expensive method to re-work the wells than the method NL thought it would use. NL also sued Holditch, asserting that Holditch failed to use reasonable care in reviewing GHR's designs.

GHR moved for partial summary judgment asking the district court to dismiss only NL's claim for punitive damages and its breach of contract and negligence theories. The district court, however, issued an order dismissing NL's entire complaint against GHR. Also, the district court granted Holditch's motion for summary judgment after concluding that Holditch was an arbiter under the agreement and, therefore, was not liable to NL for negligence.

We AFFIRM the district court's decision to dismiss Holditch from the litigation, but because the district court did not notify NL that its entire complaint against GHR was at risk, we REVERSE that portion of the district court's order which dismissed issues not raised in GHR's motion for partial summary judgment; those claims are REMANDED to the district court for further proceedings. We AFFIRM the dismissal of NL's claim for punitive damages, negligence, and most of the issues raised under its breach of contract theory. But NL has produced enough evidence that GHR's method for servicing the wells did not conform to the agreement to survive summary judgment; therefore, we REVERSE the dismissal of that portion of NL's breach of contract theory and REMAND it back to the district court.

## I. FACTS AND PROCEDURAL HISTORY

### A. The Ill-Fated Workover Agreement

Most of GHR's income comes from the production of oil and gas from more than 300,000 acres of mineral leaseholds in Webb and Zapata counties in Southwest Texas. To generate more revenue for GHR's bankruptcy estate,[1] in April 1985 the bankruptcy court authorized GHR to enter into a workover agreement with NL, an internationally known corporation specializing in wellsite drilling services. *See* Agreement for Recompletion, Reworking and Related Activities on Oil and Gas Wells in Webb and Zapata Counties, Texas ("Agreement") *reprinted in* Exhibits to NL's Memorandum in Opposition to GHR's Motion for Partial Summary Judgment ("NL's Exhibits"), vol. 1, tab 1. The workover agreement provided that NL would use "production enhancement procedures" to increase production from ten of GHR's existing gas wells.

Production from a well can be increased in a number of ways,[2] but in this case, GHR asked NL to augment production by fracturing the hydrocarbon formations under the wells. "Fracturing" is "[a] process of opening up underground channels in hydrocarbon-bearing formations, by force, rather than by chemical action such as acidizing." *See* 8 H. Williams & C. Meyers, *Oil and Gas Law* 379 (1987) [hereinafter *Oil and Gas Law*]. A liquid or other substance, such as sand, is pumped into a well "to crack (fracture) and prop open the hydrocarbon bearing formation" and create

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[1] After the Chapter 11 petitions were filed, GHR continued to operate its business as a debtor in possession under the name "TransAmerican Natural Gas Corporation."

[2] For the numerous ways in which production from a well can be enhanced, see 8 H. William & C. Meyers, *Oil and Gas Law* 758 (1987).

channels through which the gas or oil can be extracted. *See id.* at 377. The method by which this is done is referred to as a "fracture treatment" or "frac."

The agreement required NL to finance the workover of the ten wells. To compensate NL for its services, GHR assigned NL a "proceeds production payment" equal to seventy-five percent of the "incremental net revenues" attributable to GHR's working interest in the wells. *See* Agreement, Exhibit 7. In other words, NL would receive seventy-five percent of the net revenue from the sale of that portion of the gas attributable to the production enhancement procedures. The agreement stated that the income from the proceeds production payment was to be NL's only source of compensation. *See* articles 5.1, 5.2. NL also received a right of first refusal for the performance of similar procedures on forty of GHR's other wells.

The agreement stipulated that GHR was to determine the method for servicing the wells. GHR was to give NL a "detailed written prognosis" explaining how the production enhancement procedure for each well should be carried out, and NL was to perform each procedure "in strict accordance" with the prognosis unless GHR and NL agreed otherwise. *See* articles 4.1.a., 4.3.a. If GHR failed to submit the prognosis or if GHR's instructions were inadequate, NL was required to notify GHR in writing. If GHR did not provide NL with the proper instructions within ten days, NL had the right to terminate the agreement. *See* article 4.3.d.

GHR wanted NL to fracture the wells. As with other production enhancement procedures, the agreement required GHR to instruct NL how to perform the fracture treatment, but its frac design was to be based on a model

supplied by Holditch, a petroleum engineering consultant.[3] The agreement required GHR to provide NL with instructions for fracturing the well and with a fracture program approved by Holditch; if it failed to do so within ten days after being notified by NL, GHR was deemed to have elected not to fracture the well, and NL was to perform other production enhancement procedures stipulated by the prognosis. *See* article 4.3.i.3.

The agreement also contained provisions to comfort GHR's secured lenders, referred to as the "Banks." From the beginning, the Banks were intimately connected to the agreement between GHR and NL. Before GHR could assign the proceeds production payment to NL, the Banks had to subordinate their pre-existing security interests in the production of GHR's wells. Moreover, like any secured lender, the Banks needed to be confident about the financial viability of GHR before they would confirm GHR's plan of reorganization. Recognizing this, the bankruptcy court required GHR

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[3] Specifically, the agreement states that

> GHR shall design the specific fracture or other formation stimulation program for a particular Subject Well *based upon a model prepared by Holditch*, and *shall submit to Holditch for review and approval the design for each proposed fracture* or other formation stimulation program and an authority for expenditure ("AFE") setting forth the estimated costs to be incurred in connection therewith. If Holditch does not approve the design and AFE for the relevant proposed program, Holditch shall make such modifications thereto as Holditch deems necessary. GHR and [NL] understand and agree that *all decisions or modifications by Holditch of or with respect to any proposed fracture or other formation stimulation program submitted by GHR pursuant hereto shall be final and binding upon the Parties.* Any fracture or other formation stimulation program designed by GHR and approved by Holditch as provided herein shall be referred to hereinafter as an "Approved Fracture Program."

*See* article 4.3.i.1 (emphasis added).

to insert several provisions into the workover agreement to protect the Banks.[4]

The agreement contained other clauses that benefitted the Banks in addition to those required by the bankruptcy court,[5] the most important of which provided that GHR could not authorize workovers on *any* well before Holditch and two other petroleum engineering consultants, Netherland, Sewell and Associates ("NSA") and B.P. Huddleston & Co. ("Huddleston"), certified to the Banks that the workover would increase the discounted present value of future net revenue realized from each well by more than the anticipated cost of the workover. *See* article 4.1.c. Although the Banks required GHR to include these provisions in the agreement, the Banks were not a third-party beneficiary of the agreement. *See* article 6.8.

As GHR explained to the bankruptcy court when it sought permission to consummate the agreement with NL, the parties expected the agreement to benefit everyone. GHR's

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[4] For example, the bankruptcy court required that the agreement contain the following provisions: that GHR was not permitted to authorize production enhancement procedures on any wells other than the initial ten wells without obtaining written permission from the Banks; NL was not permitted to exercise its right of first refusal for the performance of production enhancement procedures on the additional wells unless the Banks received written verification that NL had matched the lowest bid for these services; and that NL would commit a material breach of the agreement if it failed to pay its contractors or if it allowed a materialman's lien to encumber the wells. *See* Order Authorizing Debtors to Enter Into Agreement for Recompletion, Reworking and Related Activities with NL Industries, Inc., *reprinted in* Defendants GHR Energy Corporation and Southern States Exploration Inc.'s Motion for Partial Summary Judgment, Exhibit A, tab 135.

[5] For example, the Banks had the right to monitor NL's progress in servicing the wells. *See* article 4.3.j. Also, GHR could not authorize production enhancement procedures for any well producing more than 2,000,000 cubic feet of gas per day without the Bank's permission. *See* article 4.1.c.

bankruptcy estate would be benefitted by increased production, and "[n]et revenues to GHR [would] increase dramatically once the procedures desired [were] employed." *See* Motion for Authority to Enter Into Agreement with NL Industries, Inc. to Perform Recompletions, Workovers, and Related Activities at 6, *reprinted in* Defendants GHR Energy Corporation and Southern States Exploration Inc.'s Motion for Partial Summary Judgment, Exhibit B, tab 135. Moreover, the agreement would impose no cash drain on the resources of GHR because NL would be paid only from increased production. As it turned out, the agreement benefitted no one. A portion of the parties' misfortune can be ascribed to gas prices, which, instead of increasing from $3.40 to $7.50 per mcf (1000 cubic feet), as the parties had predicted, plummeted to less than $2.50 per mcf. NL attributes the remainder of the blame for its misadventure to GHR.

To induce NL to enter into the agreement, GHR had assured NL that the revenue produced by the workovers would compensate it for its expenses within six months. GHR estimated that the production enhancement procedures on the ten wells would cost about $9 million and would produce almost $65 million in present value net revenue. The workover actually cost more than $14 million and produced only $5.4 million in revenue. But NL did not rely solely on GHR's sales pitch; before signing the agreement, NL received a more modest projection from NSA. Using GHR's estimates of the cost of the workovers, NSA estimated that future revenue, discounted to present value, would be $26,647,000. *See* Letter to Peter H. Nielsen of NL from Clarence M. Netherland of NSA, *reprinted in* Exhibits to GHR's Supplemental Memorandum in Support of Motion for Partial Summary Judgement [sic] and Response to NL's Opposition ("GHR's Exhibits"), tab 8. GHR implies

that NL also relied on a third projection from Huddleston, which estimated future net revenue to be $23 million. But this letter was dated May 14, 1985, more than a month after the parties signed the agreement. *See* GHR's Exhibits, tab 9.

NL attributes the high cost of servicing the wells and the subsequent lack of revenue to GHR's frac designs. Before entering the agreement with NL, GHR presented NL with a report which explained that GHR had performed fracture treatments on a series of fifty-five of its wells and had obtained $34 million of incremental net income within the first fourteen months of production. *See* Technical Report, attached as Exhibit A to Affidavit of Robert J. Hurley, *reprinted in* NL's Exhibits, vol. 1, tab 2. According to NL, all but three of these fifty-five fracture treatments were tailored to the characteristics of the reserves of each well. In other words, the length of each fracture treatment was designed specifically to extract as much gas as possible from a known reservoir. NL insists that it believed that GHR would use this type of frac to enhance production from the ten gas wells covered by the agreement and that article 4.3.i.1 of the agreement limited GHR to this type of frac when it stated that any frac used must be "based upon a model prepared by Holditch."

The fracture treatments that GHR prescribed for the ten wells were not tailored to the contours of each reservoir, however. Instead, GHR used what NL hyperbolically describes as "massive experimental fracs," which were each 1500 feet long. By fracturing an area larger than the known reservoir, GHR hoped to extract hydrocarbons from potential, adjacent reservoirs without having to drill a new well.

GHR submitted its proposed fracs for seven of the ten wells to Holditch, and Holditch approved them. GHR did not ask Holditch to review its fracture treatment designs for the other three wells. Nevertheless, by December 1985, NL

had completed the procedures on all ten wells. Because the incremental net revenue from the wells was much less than expected, NL did not receive enough to reimburse it for its costs.

B. The Road to Recovery

In August 1986, NL sued GHR in federal district court alleging state law claims for breach of contract, mutual mistake, misrepresentation, fraud, and negligence. *See* Complaint, *reprinted in* Record on Appeal ("R."), vol. 5, tab 1, at 1114. NL sought $15,157,491 in actual damages and three times that amount in punitive damages. Jurisdiction was based on diversity of citizenship. That same day, NL filed a proof of claim in bankruptcy court for $15,157,491, which NL stated was "[t]he full amount of [its] claim." *See* Proof of Claim at 2, *reprinted in* NL's Exhibits, vol. 2, tab 16. NL sought priority for its claim as an administrative expense, undertaken to preserve GHR's bankruptcy estate. *See* Bankr. Code §§ 503(b)(1)(A), 507(a)(1).

In September 1986, GHR filed its answer to the district court proceeding and its objection to NL's proof of claim in the bankruptcy court. One month later, GHR removed the district court proceeding to the bankruptcy court. NL filed a motion to withdraw reference, stating that the bankruptcy court lacked jurisdiction to adjudicate the merits of NL's state law claims because these claims were not "core proceedings." *See* 28 U.S.C.A. § 157(b) (West Supp. 1990). The bankruptcy judge agreed with NL and recommended that the district court retain jurisdiction over the case. The district judge agreed and entered an order retaining jurisdiction of NL's claims. In the meantime, NL amended its district court pleading adding Holditch as a defendant. In September 1987, the bankruptcy court confirmed GHR's Chapter 11 reorganization plan and classified NL's claim as

a disputed administrative expense to be paid if the district court found GHR liable.

In October 1989, Holditch moved for total summary judgment, *see* R., vol. 4, tab 133, at 356, and GHR filed a motion for partial summary judgment, *see* Defendants GHR Energy Corporation and Southern States Exploration Inc.'s Motion for Partial Summary Judgment ("Partial Summary Judgment Motion"), R., Loose in File, tab 135. NL filed memoranda opposing both summary judgment motions and also filed a motion seeking leave to amend its complaint again to assert additional claims against GHR and Holditch. The district court granted summary judgments in favor of both Holditch and GHR dismissing all NL's claims against them. The court did not notify NL that it was considering dismissing NL's entire case against GHR. In addition to granting both summary judgment motions, the court refused to give NL leave the amend its complaint. NL appeals, arguing that both summary judgment motions were improperly granted and that the district court abused its discretion when it refused to allow NL to amend its complaint.

## II. DISCUSSION

### A. Standard of Review

Like the district court, we must review the entire record to determine whether NL has presented enough evidence to warrant a trial on the merits of its actions against Holditch and GHR. *See Dunn* v. *State Farm Fire & Cas. Co.*, 927 F.2d 869, 872 (5th Cir. 1991). Our review is guided by the same considerations that a district court would follow in deciding whether to grant a directed verdict: does "the evidence present[] a sufficient disagreement to require submission to a jury or [is it] so one-sided that one party must prevail as a matter of law"? *See Anderson* v. *Liberty Lobby,*

*Inc.*, 477 U.S. 242, 251-52, 106 S. Ct. 2505, 2512, 91 L.Ed.2d 202 (1986).

B. Summary Judgment in Favor of Holditch

Article 4.3.i.1 required GHR to submit its frac designs to Holditch for review, authorized Holditch to modify GHR's designs, and provided that "all decisions or modifications by Holditch" with regard to these designs would "be final and binding upon" GHR and NL.[6] In January 1987, when it added Holditch as a defendant to its suit against GHR, NL sought to recover damages from Holditch under a negligence theory by asserting that Holditch had not used reasonable care in reviewing GHR's designs. *See* NL Industries, Inc.'s Motion for Leave to File First Amended Complaint at 2, *reprinted in* R., vol. 2, tab 16, at 818. In October 1989, Holditch moved for summary judgment arguing that it was an arbiter under the contract and that it could not be liable to NL for negligence.

Texas law permits parties to appoint an expert to act as an arbiter in reviewing engineering or construction designs before they are carried out. The language of article 4.3.i.1 is similar to the language of other arbiter provisions and clearly expresses the parties' intent to name Holditch as an arbiter. *Compare City of San Antonio* v. *McKenzie Constr. Co.*, 136 Tex. 315, 325, 150 S.W.2d 989, 995 (1941); *Hooks* v. *Cook*, 345 S.W.2d 592, 592-93 (Tex. Civ. App. — Houston 1961, writ ref'd n.r.e.); *Uvalde Rock Asphalt Co.* v. *Fantham*, 210 S.W.2d 646, 648 (Tex. Civ. App. — Galveston 1948, no writ) *with Black* v. *Acers*, 178 S.W.2d 152, 154-55 (Tex. Civ. App. 1943, writ ref'd) (holding that parties who agreed that a house was "to meet requirements of the Federal Housing Administration," did not intend to appoint the FHA as an arbiter). NL argues that article 4.3.i.1 is

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[6] For the full text of article 4.3.i.1, see note 3, *supra*.

ambiguous because article 6.7 of the workover agreement provided that any dispute between GHR and NL is to be resolved through arbitration, and if Holditch were an arbiter under the agreement, article 6.7 would be superfluous. But the parties only authorized Holditch to review and approve frac designs, not to resolve every dispute that could arise under the agreement. Therefore, the existence of article 6.7 does not tarnish Holditch's interpretation of article 4.3.i.1. Article 4.3.i.1 unambiguously appointed Holditch to be an arbiter for the design of the fracture treatments for the ten wells.

If the parties do appoint an arbiter, the arbiter's decision is final and conclusive unless the arbiter "is guilty of fraud, misconduct, or such gross mistake as would imply bad faith or failure to exercise an honest judgment." *See McKenzie Constr. Co.*, 136 Tex. at 326, 150 S.W.2d at 996; *State* v. *Buckner Constr. Co.*, 704 S.W.2d 837, 841 (Tex. App. — Houston [14th Dist.] 1985, writ ref'd n.r.e); *Austin Bridge Co.* v. *State*, 550 S.W.2d 135, 137 (Tex. Civ. App. — Waco 1977, writ ref'd n.r.e); *Plantation Foods, Inc.* v. *R.J. Reagan Co.*, 520 S.W.2d 432, 434 (Tex. Civ. App. — Waco 1975, writ ref'd n.r.e). Consequently, Holditch could not be liable under a negligence theory, and the district court properly granted summary judgment in its favor.

NL's final argument is that the district court should have permitted it to amend its pleading to allege a variety of additional complaints against Holditch. The district court denied NL's motion for leave to file its second amended complaint, and the court did not abuse its discretion in doing so. *See Overseas Inns S.A. P.A.* v. *United States*, 911 F.2d 1146, 1150 (5th Cir. 1990). If a plaintiff seeks to amend its pleading after a responsive pleading has been served, it must seek "leave of court" or "written consent of the

adverse party;" then, "leave shall be freely given when *justice so requires.*" *See* Fed. R. Civ. P. 15(a) (emphasis added). NL sought to amend its pleading two years after it first brought Holditch into the litigation and only after Holditch had requested summary judgment. As NL provided no good reason for not acting sooner, justice did not require the district court to permit NL to amend its pleading. *See id.* at 1151 ("A party should not, without adequate grounds, be permitted to avoid summary judgement by the expedient of amending its complaint.").

C. Summary Judgment in Favor of GHR.

1. *The Validity of Sua Sponte Summary Judgment*

In its motion for partial summary judgment, GHR first sought the dismissal of NL's action for punitive damages. GHR argued that its Chapter 11 reorganization plan discharged it from liability for punitive damages because NL never filed a proof of claim for punitive damages; i.e., NL's proof of claim was limited to the amount of its actual damages. Next, GHR raised affirmative defenses to NL's negligence and breach of contract complaints. First, GHR asserted that because Holditch was an arbiter and approved all GHR's frac designs, GHR was shielded from negligence. Second, GHR contended that it had not breached the contract because it continued to pay NL the money due under the contract.[7] GHR did not ask the court to dismiss NL's

[7] In its motion for partial summary judgment on NL's breach of contract action, GHR only raised the affirmative defense that the workover agreement limited NL's recovery to revenue from the wells, but in its response to this motion, NL not only attacked this affirmative defense but also argued the merits of its complaint. *See* NL's Memorandum in Opposition to Motion for Partial Summary Judgment of GHR Energy Corporation and Southern States Exploration, Inc. at 26-32, *reprinted in* R., vol. 1, tab 152, at 217. In a supplemental brief, GHR responded to the issues raised by NL. Presumably for this reason, NL concedes that the partial summary judgment

fraud or mutual mistake actions. Nevertheless, the district court dismissed all NL's actions against GHR sua sponte, without informing NL that it intended to do this. *See* Summary Judgment (GHR), *reprinted in* R., vol. 1, tab 203, at 42.

Rule 56(c), Fed. R. Civ. P., permits a court to grant summary judgment in favor of a party that did not request it, *Arkwright-Boston Mfrs. Mutual Ins. Co.* v. *Aries Marine Corp.*, 932 F.2d 442, 445 (5th Cir. 1991) (quoting *Celotex Corp.* v. *Catrett*, 477 U.S. 317, 326, 106 S. Ct. 2548, 2554, 91 L.Ed.2d 265 (1986)), but only "upon proper notice to the adverse party," *id.* Thus, the district court in this case could not grant summary judgment against NL without notifying NL at least ten days in advance that it intended to do so. *See* Fed. R. Civ. P. 56(c) (stating that a motion for summary judgment "shall be served at least 10 days before the time fixed for the hearing"); *Celotex*, 477 U.S. at 326, 106 S. Ct. at 2554; *Burns* v. *Gadsden State Community College*, 908 F.2d 1512, 1516 (11th Cir. 1990); *Interco Inc.* v. *National Sur. Corp.*, 900 F.2d 1264, 1268 (8th Cir. 1990); *Caribbean Produce Exch., Inc.* v. *Secretary of Health and Human Servs.*, 893 F.2d 3, 6 (1st Cir. 1989); *Pliley* v. *Sullivan*, 892 F.2d 35, 37 (6th Cir. 1989). The notification requirement enables the non-movant to place all the evidence supporting its position into the record so that a reviewing court can decide whether the non-movant has demonstrated the existence of a genuine dispute regarding a material fact. *See Jardines Bacata, Ltd.* v. *Diaz-Marquez*, 878 F.2d 1555, 1560-61 (1st Cir. 1989). Any reasonable doubts about whether NL received notice that its entire case was at risk must be resolved in favor of NL. *See id.* at 1561.

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motion encompassed its breach of contract complaint. *See* Appellant Brief for NL at 24.

To exploit the district court's beneficence, GHR attempts to convert its motion entitled "Motion for Partial Summary Judgment" into a motion for total summary judgment, and it argues that its motion notified NL that GHR was attacking the entire complaint. At the beginning of its motion, GHR stated that it was asking for summary judgment against NL on "claims for damages *in excess of [NL's] alleged administrative claim expense* and upon the issues of negligence and breach of contract." *See* Partial Summary Judgment Motion at 1 (emphasis added). GHR contends that this phrase notified NL that it was asking the district court to dismiss everything other than NL's administrative claim, which was still pending before the bankruptcy court. Therefore, GHR reasons, because NL's administrative claim is still "pending," GHR's motion really was a motion for "partial" summary judgment.

GHR's argument is disingenuous. First, it is clear from reading the entire motion that GHR used the phrase "claims for damages in excess of [NL's] alleged administrative claim" to refer to NL's claim for punitive damages for which NL did not file a proof of claim and which, therefore, exceeded NL's administrative claim. Second, NL's administrative claim in the bankruptcy court encompassed NL's district court claims. NL's administrative claim does not entitled NL to any damages absent a determination of liability in the district court.

Because NL did not receive notice that the district court was considering dismissing its entire complaint against GHR, that portion of the summary judgment which granted GHR relief exceeding that which it requested is reversed. The remaining fraud and mistake complaints should be resolved by the district court, not the bankruptcy court, *see Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 61, 102 S. Ct. 2858, 2866, 73 L.Ed.2d 598

(1982), and, therefore, we remand those claims to the district court with instructions to retain jurisdiction of those claims until it has disposed of them.

2. *NL's Motion to Amend Its Pleading*

After GHR filed its motion for partial summary judgment, NL sought to amend its pleading to allege additional complaints against GHR. The district court denied that motion because it "would not add to or detract from the Court's decision to grant [GHR's] motion[ ] for summary judgment." *See* Order, *reprinted in* R., vol. 1, tab 202, at 50. NL sought to amend its pleading more than three years after it filed its first complaint against GHR and only after GHR moved for summary judgment. Therefore, the district court would not have abused its discretion had it chosen to deny NL leave to amend because of undue delay. *See Foman* v. *Davis*, 371 U.S. 178, 182, 83 S. Ct. 227, 230, 9 L.Ed.2d 222 (1962). However, because the court tied its refusal to the order granting summary judgment, and because the summary judgment was too broad, we will reverse the order denying leave to amend and give the district court the opportunity to reconsider its decision in the light of this opinion. We now consider whether the district court properly granted summary judgment on those issues that were raised in GHR's motion.

D. Issues Addressed in GHR's Motion for Partial Summary Judgment

1. *Punitive Damages*

When NL filed its initial complaint against GHR, it alleged that it had suffered $15,157,491 in actual damages, and it requested "three times that amount" in punitive damages. But NL submitted a proof of claim to the bankruptcy court stating that the "full amount" of GHR's liability was $15,157,491. Based on this, GHR contends that the

bankruptcy court did not provide for NL's claim for punitive damages in GHR's Chapter 11 reorganization plan and that, therefore, NL's claim for punitive damages has been discharged.

Because NL was seeking to recover an administrative expense from GHR's bankruptcy estate, it should have requested "payment of an administrative expense" under section 503(a) of the Bankruptcy Code, rather than filing a proof of claim under section 501. NL can recover punitive damages from the estate as an administrative expense only if it can prove that this expense was an "actual, necessary cost, [ ] . . . of preserving the estate." *See id.* § 503(b)(1)(A). Courts have construed the words "actual" and "necessary" narrowly: the debt must benefit GHR's estate and its creditors. *See In re Dant & Russell, Inc.*, 853 F.2d 700, 706 (9th Cir. 1988); *In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987); *Trustees of the Amalgamated Ins. Fund* v. *McFarlin's, Inc.*, 789 F.2d 98, 101 (2d Cir. 1986). NL's claim for actual damages would be necessary for preserving the estate because GHR's liability was "incurred so that [it] might receive the benefits of the contract." *See In re Kent Holland Die Casting & Plating, Inc.*, 125 B.R. 493, 503 (Bankr.W.D.Mich. 1991). This cannot be said of NL's claim for punitive damages. Under the facts of this case, we can conceive of no way in which allowing punitive damages would benefit GHR's estate. Consequently, the district court correctly dismissed NL's action for punitive damages.

2. *Breach of the Workover Agreement*

NL alleges that GHR breached the workover agreement in three ways: first, by not designing fracs based on the "Holditch Model"; second, by not obtaining economic certifications that the revenue created by the production enhancement procedures would exceed the cost of those procedures; and, finally, by failing to obtain Holditch's

approval for three of the ten fracture treatments. GHR responds that it did not breach the workover agreement but, even if it did, that article 5.2 limits NL's damages to the incremental net revenue produced by the wells.

a. Does Article 5.2 Limit NL's Damages?

Article 5.2 states that for all claims arising under the contract, NL must look exclusively to the incremental net revenue from the wells and, if this revenue is insufficient, that NL has no recourse against GHR or any of its managers or employees.[8] GHR contends that this clause limits NL's damages. NL responds that this is a "production payment" clause, which deals with amounts owed to NL for its services, not with damages occurring as a result of a breach of the agreement.

The district court made no ruling on the proper interpretation of article 5.2.[9] Under Texas law, however, a court must

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[8] The relevant portion of article 5.2 states that NL

> shall look exclusively to the Incremental Net Revenues received by [NL] under the terms of the Assignments covering the relevant series of Subject Wells for the satisfaction of all costs and contractual amounts due to be paid to [NL] pursuant to the terms hereof and *for all other claims arising hereunder* with respect to such series of Subject Wells. If the Incremental Net Revenues from the relevant series of Subject Wells are insufficient to satisfy in full all of such costs, contractual amounts due, and *all other claims occurring hereunder to be paid to [NL]* pursuant hereto with respect to such series of Subject Wells, neither GHR not [sic] any officer, director, shareholder, employee, subsidiary, or affiliate or GHR shall be personally liable for the payment of any such deficiency and [NL] *shall have no recourse against GHR*, any of the officers, directors, shareholders, employees, subsidiaries, or affiliates of GHR, or any other assets or property of GHR in the event of such a deficiency.

(emphasis added).

[9] NL asserts that the district court held that article 5.2 "precluded GHR from being liable for *any* revenue shortfall regardless of GHR's misrepresentation, fraud, mutual mistake,

determine, as a matter of law, whether a provision in a contract is ambiguous. *See Callaway* v. *Overholt*, 796 S.W.2d 828, 831 (Tex. App. — Austin 1990, writ denied); *Tuscarora Corp.* v. *HJS Indus., Inc.*, 794 S.W.2d 435, 438 (Tex. App. — Corpus Christi 1990, writ denied); *Richland Plantation Co.* v. *Justiss-Mears Oil Co.*, 671 F.2d 154, 156 (5th Cir. 1982). Consequently, even if the district court had interpreted article 5.2, we would review its interpretation *de novo*. *See Forest Oil Corp.* v. *Strata Energy, Inc.*, 929 F.2d 1039, 1043 (5th Cir. 1991). For this reason, and because this issue was raised on summary judgment and undoubtedly will reappear following remand, we have reviewed the language of that article in the light of other provisions in the contract.

Viewed apart from the rest of the contract, the language of article 5.2 is expansive enough to encompass NL's damage complaint against GHR for breaching the workover agreement; it states that NL must look to the incremental net revenue from the wells "for the satisfaction of all costs and contractual amounts due . . . and all other claims arising" under the agreement and that, if there is a deficiency, NL shall have "no recourse" against GHR. But language in the remainder of the contract belies that interpretation and demonstrates that the parties intended this to be a production payment clause.

A production payment is a share of the mineral interest produced from land, "free of the costs of production at the

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negligence, gross negligence, or breach of contract." *See* Appellant Brief for NL at 27 (emphasis in orignal). The district court made no such finding. In its recitation of the facts, the court noted that "the agreement and the Plan state that in the event the revenues are insufficient, NL Industries has no recourse against GHR, its officers, agents or affiliates." *See* Summary Judgement (GHR) at 2. This just paraphrases the wording of article 5.2.

surface, terminating when a given volume of production [has] been paid over or when a specified sum from the sale of such [minerals has] been realized." 2 *Oil and Gas Law* § 422, at 365-66 (1990) (footnotes omitted). It is very similar to an overriding royalty, the only difference being that an overriding royalty usually continues until the termination of the mineral lease, while a production payment usually terminates when its owner has received a specific amount of money. *See id.* § 422.3, at 385.

If article 5.2 is a production payment clause, it would not prevent NL from recovering additional damages if GHR breached the workover agreement. The owner or operator of a gas well must protect the interest of the owner of a production payment or an overriding royalty, particularly in a case such as this, in which the entire reimbursement for NL's services was to come from the production payment. *See id.* § 420.1, at 356.1-356.2. If the owner or operator of the gas well does something to diminish the value of the mineral interest, the owner of a production payment or an overriding royalty can sue for damages. *See, e.g., Whitson Co.* v. *Bluff Creek Oil Co.*, 156 Tex. 139, 146-47, 293 S.W.2d 488, 492 (1956) (holding that the operator of an oil well was liable for damages to the owner of an overriding royalty after the operator negligently destroyed the well when it attempted to eliminate excess water that the well was producing); *Natural Gas Distrib. Corp.* v. *Williams*, 355 S.W.2d 194, 198 (Tex. Civ. App. — Waco 1962, writ ref'd n.r.e.) (commingling of interest owner's gas with gas from other wells); *Natural Gas Distrib. Corp.* v. *Williams*, 292 S.W.2d 353, 356 (Tex. Civ. App. — Beaumont 1956, writ dism'd) (producing less gas from the well than the well was entitled to produce); *King* v. *Swanson*, 291 S.W.2d 773, 776 (Tex. Civ. App. — Eastland 1956, no writ) (failure to drill an offset well).

The language of the contract supports NL's contention that article 5.2 only refers to NL's rights under the contract to recover its costs and does not limit NL's damages if GHR breached the workover agreement. The most persuasive evidence that article 5.2 does not refer to "causes of action" is the language of article 4.3.k, which states that NL shall indemnify GHR "against any and all claims, demands, damages, losses, or causes of action of any kind or character (including without limitation the amounts of any judgments, penalties, interest, court costs, and legal fees incurred in the defense of same) arising in favor of any third party . . ." If the parties intended article 5.2 to limit NL's right to recovery against GHR, the parties would have used language similar to that of article 4.3.k, rather than simply stating that NL must use proceeds from the well to cover all its "claims."

The structure of article 5 also indicates that it was meant to apply to NL's right to compensation, not its right to tort or contract damages. The title for article 5 is "Reimbursement," and the heading of article 5.2 is "Procedure for Reimbursement." The introductory paragraph, article 5.1, summarizes the effect of GHR's assignment of the proceeds production payment, stating that NL "shall be reimbursed for all costs and contractual amounts due . . . and *for all other claims arising*" under the contract. Thus, although article 5.1 plainly refers only to NL's right to payment for its services, it uses language similar to that of article 5.2.

In this action, NL is not simply seeking reimbursement for the costs of its services. Rather, it is seeking to recover damages caused by GHR's alleged breach of the terms of the workover agreement. By its terms, article 5.2 applies only to "reimbursement." Therefore, we conclude that it is a production payment clause, not a damage limitation provision.

b. Did NL present any evidence that GHR breached the workover agreement?

NL's primary contention is that GHR breached the workover agreement by not designing its fracture treatments in a manner consistent with the "Holditch Model." To support its argument, NL presented an affidavit from Antonin Settari, an engineer, who defined the "Holditch Model" as a concept for fracturing wells, which appeared in various Holditch publications and in professional literature. *See* Affidavit at 2, NL's Exhibits, vol. 1, tab 11. Settari testified that under the Holditch Model, the length of the fracture treatment varies with the well drainage area and the permeability of the hydrocarbon formation. *See id.* at 3. According to Settari, the fracture treatments designed by GHR, which employed uniform fracture lengths of 1500 feet for each well, were experimental and did not conform to the Holditch Model. *See id.* at 5-7.

GHR points out that the agreement never used the term "Holditch Model" but required GHR to base its design on "a model prepared by Holditch." *See* article 4.3.i.1. GHR did design its fracture treatments using a computer program that was developed and sold by Holditch. *See* Transcript of Deposition of Oscar Garcia at 26-27, *reprinted in* Supplemental Record Excerpts for Holditch, vol. 2, tab E, at 344. Consequently, GHR contends that it complied with the contract.

After reviewing the existing record, we believe that NL has demonstrated that article 4.3.i.1 is ambiguous and, therefore, that the district court must conduct a factual inquiry to determine what the parties understood that provision to mean. *See Security State Bank* v. *Valley Wide Elec. Supply Co.*, 752 S.W.2d 661, 665 (Tex. App. — Corpus Christi 1988, writ denied); *Richland Plantation*, 671 F.2d at 156. First, although GHR is correct in stating that the contract did not use the term "Holditch Model," article 4.3.i.1 also states that "GHR shall design the *specific* fracture or other

formation stimulation program for a *particular* Subject Well" (emphasis added). This language is consistent with NL's interpretation of the clause and is inconsistent with GHR's frac designs, which were uniform and were not designed specifically for a "particular" well.

Second, NL has shown that the fracture treatment used by GHR was uncommon at the time GHR and NL signed the workover agreement. In March 1986, three months after NL had completed the workovers, Holditch prepared a report for GHR that summarized and evaluated the production of 300 GHR wells, seven of which had been treated with the large fracture lengths. *See* Holditch Report, Exhibit G, Holditch & Associate Inc.'s Motion for Summary Judgment, *reprinted in* NL Record Excerpts, vol. 1, tab 15. The tone of that report indicates that the fracture design was new and that GHR was not sure whether it would work. The report's stated purpose was "to assess whether the large, high sand concentration fracture treatments currently being pumped are economically justifiable." In addition, after summarizing the theory behind the longer fracture lengths, the report stated that, "*if successful*," the fracs would "increase the area drained by a typical well" (emphasis added).

Finally, NL presented evidence which would support a conclusion that it had no reason to know that GHR intended to use uniform fracs to enhance production from all the wells.[10] These frac designs were used in only three of the

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[10] Even if GHR did subjectively intend to use longer fracture treatments when it signed the contract, NL's interpretation will be upheld if NL had no reason to know GHR's intention, and GHR had reason to know that NL thought that GHR was going to use the more conventional fracs. *See* Restatement (Second) of Contracts § 20(2)(b)(1981); *Exxon Corp.* v. *Bell*, 695 S.W.2d 788, 790 (Tex. App. — Texarkana 1985, no writ); *Volpe* v. *Schlobohm*, 614 S.W.2d 615, 618 (Tex. Civ. App. — Texarkana 1981, no writ); *Mid-South Packers, Inc.* v. *Shoney's Inc.*, 761 F.2d 1117, 1122 (5th Cir. 1985).

fifty-five wells that GHR used to promote the workovers to NL, and Peter Nielsen, NL's Director of Planning and Business Development, testified that NL did not realize that the fracs it had agreed to finance would be substantially different from fracs that GHR had used in those fifty-five wells, *see* Transcript of Deposition at 982, *reprinted in* NL's Exhibits, tab 4.

On appeal, GHR argues that even if its fracs did not conform to NL's understanding of article 4.3.i.1, the agreement provided that Holditch was to review GHR's fracture designs and that Holditch's approval of those designs was final and binding on NL. Even though GHR is correct in its assessment of Holditch's role in reviewing and approving its fracs, Holditch did not have the authority to approve a frac that did not conform to the agreement, i.e., one that was not "based upon a model prepared by Holditch." If the agreement required GHR to design one type of frac, and GHR designed another, Holditch's approval of GHR's design would not sanitize GHR's breach of the agreement. *See Martin Bros.* v. *State*, 146 S.W.2d 782, 785-86 (Tex. Civ. App. — Austin 1940), *rev'd on other grounds*, 138 Tex. 505, 160 S.W.2d 58 (1942); *W.L. Pearson & Co.* v. *Hutchinson County, 52 S.W.2d 509, 516 (Tex. Civ. App. — Amarillo 1932, writ ref'd) (on motion for rehearing);* 7 TEX. JUR. 3D *Architects and Engineers* § 15, at 93 (1980); 10 TEX. JUR. 3D *Building and Construction Contracts* § 15, at 231 (1980).

Because NL has proven that a genuine dispute exists regarding the type of fracture treatment which GHR was to design for the wells, we reverse the district court's decision to grant summary judgment on that issue. NL has presented no evidence, however, to support its contention that GHR breached two other provisions of the workover agreement. Therefore, we affirm the summary judgment on those grounds.

First, NL contends that GHR failed to submit three of the ten fracture treatments to Holditch for review and approval as required by article 4.3.i.1. Although NL's assertion is factually correct, article 4.3.i.3 of the agreement provided that NL was required to notify GHR if it failed to receive the approved fracture program for a well and that, if GHR failed to respond to this notification within ten days, NL was "not to perform fracture or other formation stimulation procedures in the relevant" well. Therefore, if NL was injured by GHR's failure to obtain Holditch's approval, that injury was caused by NL's own breach of the agreement.

Second, NL contends that GHR breached articles 4.1.c and 4.3.d of the agreement by failing to obtain certifications from Holditch, Huddleston, and NSA as to the economic viability of each workover. Article 4.1.c required GHR to submit these certifications to the Banks, not NL. If GHR breached this provision, NL was not harmed. Article 4.3.d did require GHR to include these certifications in the production enhancement prognoses that it was to submit to NL, but, by its own terms, that clause did not "apply in any way to the establishment of fracture or other formation stimulation programs." Even if it did, article 4.3.d required NL to notify GHR if the prognoses were deficient, and NL had the right to terminate the agreement if GHR failed to respond to the notification. By failing to exercise that privilege, NL waived its right to complain about GHR's breach. *See Horton* v. *Robinson*, 776 S.W.2d 260, 264 (Tex. App. — El Paso 1989, no writ).

*3. Negligence*

Finally, NL contends that GHR was negligent in designing its fracs without sufficient data or experience and in underestimating the costs of the fracture treatments. Under Texas law, if a party does not use reasonable care in performing its obligations under a contract, it is liable for damages under

both contract and negligence theories. *See Montgomery Ward & Co.* v. *Scharrenbeck*, 146 Tex. 153, 157, 204 S.W.2d 508, 510 (1947); *Byrd* v. *Skyline Equip. Co.*, 792 S.W.2d 195, 197 (Tex. App. — Austin 1990, writ denied). Under the facts of this case, however, NL's remedy, if any, is under contract law, not negligence law. The contract provided that Holditch was to review GHR's proposed fracture treatments and that any decision by Holditch regarding the implementation of these treatments was to be final. If NL were permitted to argue that GHR did not use reasonable care in designing the fracs even though the designs conformed to the requirements of the contract, Holditch's role would be nugatory because its decision to approve those treatments would be meaningless. *See Huey* v. *Davis*, 556 S.W.2d 860, 864 (Tex. Civ. App. — Austin 1977) (noting that "[i]t is an established principle of law in Texas" that if parties name an engineer as an arbiter under a contract, the arbiter's decision cannot be avoided "without showing that the person so empowered was arbitrary"), *rev'd on other grounds*, 571 S.W.2d 859 (Tex. 1978). Consequently, the district court correctly held that the provision of the contract which appointed Holditch as an arbiter also shielded GHR from liability for negligence.

## III. CONCLUSION

The district court correctly determined that Holditch was an arbiter under the workover agreement. Therefore, to recover damages from Holditch, NL was required to show that Holditch was guilty of fraud or extreme misconduct. NL's complaint alleged only that Holditch was negligent. Consequently, the district court's decision to grant summary judgment in favor of Holditch is AFFIRMED.

In its motion for partial summary judgment, GHR did not ask the district court to dismiss NL's fraud and mutual

mistake complaints. Because the district court rejected those complaints without notifying NL that it intended to do so, that portion of the district court's order is REVERSED, and those claims are REMANDED to the district court for further proceedings. We also REVERSE and REMAND one issue that was raised in NL's breach of contract complaint and was addressed in GHR's motion for partial summary judgment: did the fracs that GHR designed for the ten gas wells meet the requirements of article 4.3.i.1 of the workover agreement? The remainder of the court's order, which dismissed NL's request for punitive damages, its negligence complaint, and the rest of its breach of contract complaint, is AFFIRMED.

## APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| NL INDUSTRIES, INC., *Plaintiff,* | § | |
| VS. | § | |
| GHR ENERGY CORPORATION AND SOUTHERN STATES, EXPLORATION INC. AND S.A. HOLDITCH ASSOCIATES, *Defendants.* | § | CIVIL ACTION NO. H-86-3334 |

### SUMMARY JUDGMENT (GHR)

In early 1983, the defendant, GHR Energy Corp. and Southern States Exploration, Inc. ("GHR"), filed voluntary petitions for reorganization pursuant to Chapter 11 of the Bankruptcy Code.

On April 24, 1985, the Bankruptcy Court entered an order granting permission for GHR to enter into an agreement with the plaintiff, NL Industries, Inc. ("NL Industries"). The order of the Bankruptcy Court expressly incorporated the terms and provisions of a contract between GHR and NL Industries, the subject of this litigation.

After the workover commenced, NL Industries, who had expressly agreed to finance the project, experienced unanticipated cost overruns. In the face of this circumstance, and because NL Industries had agreed to be paid back solely out of revenues from incremental production, NL Industries filed a proof of claim in Bankruptcy Court for some $15,157,491 plus accruing interest. This claim has not been

resolved, and the Court is of the opinion that the Bankruptcy Court retains jurisdiction of that claim. Simultaneously, NL Industries commenced a suit in federal district court against GHR asserting the same claim but in addition sought punitive damage and attorney's fees.

According to the terms of the agreement and the express order of the Bankruptcy Court, GHR would not be liable for any deficiency in NL Industries' revenue short fall. In fact, the agreement and the Plan state that in the event the revenues are insufficient, NL Industries has no recourse against GHR, its officers, agents or affiliates. These terms are undisputed.

In its motion for summary judgment, GHR contends that NL Industries should not be permitted to maintain this suit because: (a) the GHR Plan Of Reorganization ("Plan") permits a mechanism for categorizing claims and NL Industries' claim is at most a disputed administrative claim; (b) the claim filed is limited by law as well as by the manner of filing to $15,157,491 plus accruing interest; (c) neither the disclosure statement nor the plan of reorganization provides for the payment of punitive damages as an administrative claim; and (d) consummation of the Plan discharged GHR from any debt that arose prior to September 4, 1987. (The Plan was approved by the Bankruptcy Court on September 4, 1987).

In opposing GHR's motion for summary judgment, NL Industries seeks rescission of the Workover Agreement and damages for fraud, misrepresentation, breach of contract, and negligence. More particularly, NL Industries contends that GHR is not shielded from liability if the evidence shows that GHR negligently designed the fracture stimulation procedure. More particularly, if the design was experimental then the results were fraudulently misrepresented by GHR;

therefore, the discharged provisions of § 1141 of the Bankruptcy Code are also inapplicable.

To better understand the nature of this suit, some explanation of the treatment method is appropriate. The evidence establishes that commencing in the 1970's, the "fracture treatment design" method evolved. Holditch and GHR have been involved in this developmental process since the late 1970's. The procedure recognizes an interplay between fracture treatments and the subsequent production response of the Wells. In other words, the reservoir characteristics and the hydraulic fracture treatment selected all play a role in the success of the production enhancement program. The Wilcox (Lobo) Trend is one of the areas where GHR and Holditch have successfully implemented this procedure.

The method designed by Holditch, later called the Holditch Model, was designed to use sand concentration to fracture the Wells. The fracture treatment procedure was designed to increase the size of the area to be treated in order that each Well would experience an increase in production.

Holditch and GHR had performed the fracture treatment on a number of Wells since 1979. The methods generally sought fracture half-lengths of 700 to 1,000 feet utilizing 8 lb/gal. of propant in 40 to 80 acres areas. GHR's experience was that the fracture was not being completely accomplished, and that the length of the fracture was less than desired.

In 1984, GHR commenced the GHR new "high sand concentration treatment" method. This method increased substantially the treatment size of each fracture stimulation treatment. Over 300 Wells were reviewed by Holditch, which results showed that the high sand concentration method was recovering more gas. Similar information was discovered by other engineers and was published in the

Cotton Valley Formation. GHR's experience was that the longer the fracture the longer the treatment, and this method was continued.

The GHR fracture treatments were designed to: (1) achieve a uniform propped fracture half length of 1500 feet; (2) increase the concentration for all Wells to 12 lb/gal. of propant as opposed to 8 lb/gal. of propant; and (3) the larger fracture heights were selected as opposed to previous treatment. This design was implemented to increase the drainage area range, normally 40 to 80 acres, and to maximize the propped fracture half lengths past the designed lengths.

The experience of Holditch and GHR in the Wilcox Lobo Trend was that the larger the fracture treatment size, the larger the drainage area. This discovery was important because GHR had been underestimating its fracture heights prior to 1984, according to Holditch. Holditch was engaged by GHR to design the necessary software for the GHR Method. Previously, GHR had designed its own program in house.

In 1985, GHR received its software program from Holditch on the fracture design. This Well-Test package, sold by Holditch, permitted GHR to design the 10 Wells for the NL Industries/GHR contract. This method of treatment, although tested on well over 300 Wells, was not used in a substantial number of the "Recent Workover Performance Wells" presented as success stories by GHR to NL Industries. However, in at least 3 of the 55 recent workover performance Wells as well as some 300 other test Wells, the high sand concentration treatment method was successful.

After reviewing each of the various arguments made by GHR and NL Industries the Court concludes that GHR's motion for summary judgment is appropriate and should be Granted.

In this regard, the Court is of the view that consummation of the Plan which incorporated the contract between GHR and NL Industries did in fact discharge GHR from any debt based on negligence that arose prior to September 4, 1987. This contract is binding on the parties and both are entitled to enforce it. To avoid this agreement something more than mere negligence is required. See *City of San Antonio* v. *McKenzie Construction Co.*, 136 Tex. 315, 150 S.W.2d 989 (1941). The Court is also of the view that NL Industries cannot sustain a suit on negligence theories.

Generally speaking, in order to sustain a motion for summary judgment the moving party must be able to establish that one or more of the essential elements of the nonmoving party's claim is absent. *Celotex Corp.* v. *Catrett*, 477 U.S. 317 (1986). In a common-law negligence case, the plaintiff must establish that a duty was owed by the defendant in order to recover. *Bean* v. *Entex*, 744 S.W.2d 323 (Tex. App. — Houston [1st Dist.] 1988, no writ).

NL Industries asserts that GHR failed to design an adequate production enhancement procedure. However, the contract did not require GHR to design any particular enhancement procedure only that it should conform to the guidelines and criteria of S.A. Holditch & Associates. There is no dispute that Holditch reviewed the GHR Model and that Holditch did not modify or alter it. Because this was the procedure approved by the parties to the contract, no duty arose on the part of GHR to explain how the production enhancement procedure was similar or dissimilar to the Holditch Model. All parties knew that the method was a high sand concentration procedure which had been approved by Holditch.

GHR's procedure was reviewed by Holditch and NL Industries, and neither company objected to it or modified it. NL Industries does not complain that GHR unjustifiably

relied upon Holditch. In fact, the abundance of the evidence establishes that GHR had ample reason to rely upon Holditch's approval. This Court finds, that as a matter of law, GHR's reliance was justified.

NL Industries also asserts mutual mistake between it and GHR in their expectation of the success of the enhancement procedures. As a general rule, to avoid a contract for a mistake of fact, the mistake relied on must be mutual. *Griffin* v. *H.L. Peterson Co.*, 427 S.W.2d 140 (Tex. App. — Dallas 1968, no writ). Consequently, the mistake must be reflected in the written contract or the parties understanding such that the parties had a common intention not reflected by the words. *Newson* v. *Starkey*, 541 S.W.2d 468 (Tex. App. — Dallas 1976, writ ref'd n.r.e.). NL Industries claims that GHR led them to believe that it could expect early pay-out on the 10 Wells.

In the Court's view, the parties were certainly optimistic about the Well's return. Mutual optimism does not equate to mutual mistake of contract. The Court concludes that no mutual mistakes existed justifying cancellation of the contract because the claimed mistake was not part of the contractual agreement. NL Industries' reliance upon the expected early pay-out as a basis for mutual mistake is without foundation.

There is no dispute that GHR has complied with the terms and provisions of the contract. Although NL Industries seeks rescission of the contract, it is not on the basis that GHR is not in compliance. The opposite is true. NL Industries' argument is that fraud vitiated the agreement, and that the contract should be rescinded. In this regard, NL Industries asserts fraud in the inducement.

To maintain a suit for fraud or misrepresentation, the charging party must show that the charged party made a

material misrepresentation that was false, knowing the representation to be false when made, or made in a reckless disregard for the truth of the matter asserted. The party claiming fraud must also show that the statement was made with the intent that the matter be relied upon, that there was reliance and that injury occurred. *Valdes Leisure Resource Group, Inc.*, 810 F.2d 1345, 1350 (5th Cir. 1987). This test requires a review of the charging party's contract and the charged party's state of mind.

The facts indicate that both NL Industries and GHR agreed that the GHR lenders expert opinion; Holditch, Huddleston, and Netherland-Sewell, would be binding upon the parties. There is no evidence, and none has been proffered, that GHR conspired with these parties to harm NL Industries. The evidence shows that each of the companies render an opinion based upon its knowledge and experience and on data supplied by GHR. NL Industries does not contend that GHR altered or misrepresented the supplied data.

NL Industries argues that on its charge of misrepresentation, the Court must indulge all reasonable inferences. *McClure* v. *Duggan*, 674 F. Supp. 211, 220 (N.D. Tex. 1987). Without a doubt, this is true. However, this Court concludes that no misrepresentation was made.

In his deposition, Peter H. Nielsen, the Director of Planning Business Development for NL Industries admitted that GHR's lenders imposed the condition that the Well package would meet a "minimum 25 percent discounted cash flow return." Nielsen admits that NL Industries was not relying on any third party experts' certifications, but on the projected six-month pay-out that GHR and NL Industries had hoped for. In fact, NL Industries never saw any certification. Nielsen admits that the following factors played a key role in NL Industries' confidence in the program: (a) NL

Industries' confidence in the workover and pay-out procedure was GHR's incentive to put good Wells in the program; (b) GHR was the second largest gas producer in the State; (c) GHR was confident that the program would be successful; and, (d) there was no obvious reason why GHR would have wanted to harm NL Industries.

Neither the expert report nor the contract addressed a six-month pay-out for NL Industries. NL Industries admits that the early pay-out expectations came about because four additional groups of 10 Wells each were targeted for workover and, in order to effectively service the remaining 40, the first 10 must be successfully completed in short order. There is no evidence that anyone knew, at the time, that the costs would be as high or that the price of oil and gas would be as volatile. There is no evidence that GHR, or for that matter Holditch, knew or had reason to know that the procedure would not be more productive. At best, what the evidence shows is that GHR relied upon Holditch to satisfy the GHR lenders that the procedure had been reviewed.

Holditch points out in his deposition that at the time NL Industries came into the picture he was already under court [bankruptcy] order to review the stimulation procedure of some 20 to 30 Wells. There was no discussion of a role that Holditch was to play for NL Industries during the contract negotiation between GHR and NL Industries. In any event, Holditch's role was already defined. Holditch was to provide "suggestions to help them [GHR] continue to improve the work they were doing." Based upon statistically analyzed production data from over 300 Wells, Holditch concluded that the high sand concentration method was yielding more production.

The evidence, taken in a light most favorable to NL Industries, fails to show that GHR knew that the Holditch, Huddleston, Netherland-Sewell opinions were invalid or flawed

when they were rendered, or that GHR had some knowledge to the contrary, or that GHR could have acquired some better knowledge but disregarded it. GHR relied upon the experts' opinions. Assertions by NL Industries to the contrary flies in the face of unrefuted facts.

Because there is no evidence of breach of contract, negligence or misrepresentation that is actionable, there can be no basis for punitive damages. Any claim for damages must arise out of the contract agreement and the Plan, and any such action must have become actionable after September 4, 1987.

It is the Court's view that NL Industries' claims under the contract are controlled by the Plan and have not been determined by the Bankruptcy Court, which has retained jurisdiction of that aspect of the case. This Court will abstain from ruling on NL Industries' claim and remand the case to the Bankruptcy Court to determine whether that claim falls within those claims allowed by the Plan.

Summary judgment is GRANTED for GHR.

SIGNED this 31st day of January, 1990.

/s/ KENNETH M. HOYT

Kenneth M. Hoyt

United States District Judge

## APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| NL INDUSTRIES, INC., | § | |
| *Plaintiff,* | § | |
| VS. | § | |
| GHR ENERGY CORPORATION | § | CIVIL ACTION |
| AND SOUTHERN STATES, | § | NO. H-86-3334 |
| EXPLORATION INC. | § | |
| AND S.A. HOLDITCH | § | |
| ASSOCIATES, | § | |
| *Defendants.* | § | |

## FINAL JUDGMENT

Because the Court has concluded that the defendants', GHR Energy Corporation and Southern States Exploration, Inc. motion for summary judgment is meritorious and has granted it, the plaintiff, NL Industries, Inc., is entitled to take-nothing as a result of this suit.

ORDERED that NL Industries, Inc. take-nothing by their suit.

This is a FINAL JUDGMENT.

SIGNED this 31st day of January, 1990.

/s/ Kenneth M. Hoyt
United States District Judge

## APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| NL INDUSTRIES, INC., *Plaintiff,* | § | |
| VS. | § | |
| GHR ENERGY CORPORATION AND SOUTHERN STATES, EXPLORATION INC. AND S.A. HOLDITCH & ASSOCIATES, *Defendants.* | § | CIVIL ACTION NO. H-86-3334 |

## SUMMARY JUDGMENT (HOLDITCH)

The defendant, S.A. Holditch & Associates, Inc., ("Holditch") has filed a motion for summary judgment against the plaintiff, NL Industries, Inc., ("NL Industries"), seeking to have NL Industries' suit dismissed. The Court is of the opinion that Holditch's motion is meritorious, and therefore grants summary judgment in Holditch's favor.

NL Industries sued GHR Energy Corp. and Southern States Exploration, Inc. ("GHR"), and Holditch on theories of breach of contract, negligence, and misrepresentation arising out of a contract between NL Industries and GHR. In 1985, GHR, an oil and gas producer, entered into a contract with NL Industries, an oil field supply service company, to rework certain gas Wells owned by GHR. The agreement called for fracturing or refracturing of the sands in some 10 Wells. Upon completion of the first 10 Wells, NL Industries had the option to perform similar operations on four additional groups of 10 Wells.

One of the provisions of the contract required by GHR's lenders was that B.P. Huddleston & Co. ("Huddleston"), Netherland, Sewell & Associates ("Netherland-Sewell") and Holditch jointly certify to GHR's lenders that the enhancement procedures would increase the present value of the future net revenues by more than the anticipated costs of the enhancement procedures. In other words, the gas to be recovered should exceed the cost of recovering it.

Holditch is a professional engineering firm that does consulting work as petroleum engineers. In this regard, Holditch has performed numerous production enhancement procedures. Holditch's contract with GHR was to review the production enhancement procedure proposed by GHR and to report whether Holditch believed that after the procedure "the present value (discounted at the rate of 25% annually) of the future net reserves realized from the workover should exceed the aggregate of all anticipated costs of the workover."

Huddleston, a professional reservoir engineering firm, was to determine the baseline of the existing productive capability. This determination was important because it is this number that becomes the point of reference for the "future net reserves." Netherland-Sewell, another reservoir engineering firm, provided estimates of the gas reserves and expected net revenue before NL Industries and GHR signed the contract. Netherland-Sewell estimated that without a workover, the future net revenues would be $14,663,100 and that with the workover, a present net worth of approximately $26,647,000 could be realized.

To better understand the nature of this suit, some explanation of the treatment method is appropriate. The evidence establishes that commencing in the 1970's, the "fracture treatment design" method evolved. Holditch and GHR have been involved in this developmental process since the late

1970's. The procedure recognizes an interplay between fracture treatments and the subsequent production response of the Wells. In other words, the reservoir characteristics and the hydraulic fracture treatment selected all play a role in the success of the production enhancement program. The Wilcox (Lobo) Trend is one of the areas where GHR and Holditch have successfully implemented this procedure.

The method designed by Holditch, later called the Holditch Model, was designed to use sand concentration to fracture the Wells. The fracture treatment procedure were designed to increase the size of the area to be treated in order that each Well would experience an increase in production.

Holditch and GHR had performed the fracture treatment on a number of Wells since 1979. The methods generally sought fracture half-lengths of 700 to 1,000 feet utilizing 8 lb/gal. of propant in 40 to 80 acre areas. GHR's experience was that the fracture was not being completely accomplished, and that the length of the fracture was less than desired.

In 1984, GHR commenced the GHR new "high sand concentration treatment" method. This method increased substantially the treatment size of each fracture stimulation treatment. Over 300 Wells were reviewed by Holditch, which results showed that the high sand concentration method was recovering more gas. Similar information was discovered by other engineers and was published by the Cotton Valley Formation. GHR's experience was that the longer the fracture the longer the treatment, and this method was continued.

In the case at bar, Holditch's role was to estimate the gross fracture from GHR logs, calculate the porosity and water saturation from the logs, compare that data to the fracture design sent to Holditch, and then determine if the volume

was reasonable for the length of the fracture. In each case of review, Holditch determined that the volume was reasonable and that continued use of the procedure was justified. In fact, this result substantiated Holditch's view that in the Wilcox (Lobo) Trend, the larger the fracture treatment size, the larger the drainage area. It should be noted that all of the Holditch work was done in the office as opposed to the oil field.

Consequently, no essential difference exists between the Holditch Model and the GHR Method except the length of the fracture, or treatment area.

In its complaint, NL Industries contends that Holditch misrepresented or failed to inform NL Industries of the extent of the expenditures required to perform the GHR production enhancement procedures and that Holditch committed negligence and gross negligence in designing the production enhancement procedures. Holditch contends that because no contract existed between it and NL Industries, NL Industries did not rely upon any documents produced by Holditch, and, therefore, Holditch owed no legal duty to NL Industries.

Summary judgment shall be entered when there is no genuine issues of material fact and the movant is entitled to judgment as a matter of law. FED. R. CIV. P. 56(c); *Celotex* v. *Catrett*, 477 U.S. 317 (1986). In reviewing the evidence, the Court is not to weigh the evidence and determine the truth of the matters asserted but simply determine whether there is a fact issue for trial. *Anderson* v. *Liberty Lobby, Inc.*, 106 S. Ct. 2505, 2511 (1986).

In this case, NL Industries has asserted claims against Holditch under theories of negligence, gross negligence, and misrepresentations. In order to sustain Holditch's motion for summary judgment, the record must show that no false statement or representation was made to NL Industries, or

that any representation made by Holditch was not material to the transaction in question.

A representation is not material if it appears that the transaction was entered into prior to the making of the representation. 14 Tex. Jur. 3d Contracts §§ 13-15 (1981). However, if a representation is made that is material to the transaction, NL Industries must show that Holditch knew that the representation was false when it was made or that Holditch made it recklessly without any knowledge of the truth and as a positive assertion; that Holditch made the representation with the intent that NL Industries act on it; and that NL Industries relied upon it and suffered injury based on the reliance. *Valdes* v. *Leisure Resource Group, Inc.*, 810 F.2d 1345, 1349-50 (5th Cir. 1987).

The record shows that NL Industries did not rely upon any of the Holditch documents in negotiating its contract with GHR. Moreover, the contractual provision relied upon by NL Industries for the misrepresentation claim was for the benefit of the GHR lenders. In spite of the fact that NL Industries was aware that the GHR lenders and GHR expected Holditch to have the final say regarding the production enhancement procedure, NL Industries never required any assurances from Holditch.

This Court concludes that any stated reliance is after the fact and is an unjustified reliance. Reliance is only justified where some fiduciary or other relationship of trust and confidence existed between parties requiring disclosure of any fact. In his deposition Peter H. Neilsen, the Director of Planning Business Development for NL Industries testified to a question regarding assurances by the experts such as Holditch as follows:

> Q And what assurances was NL Industries requiring through third-party experts prior

to the time that issue was raised by the banks?

A None at that period in time.

The reference here is to when any assurances were made by Holditch and others. Nowhere in the Neilsen deposition or any other evidence proffered by NL Industries is there evidence of assurances by Holditch. Moreover, it was only after GHR lenders required the Holditch certification that GHR and NL Industries made it a part of their contract. While NL Industries and GHR agreed that Holditch's certification was necessary for the GHR lenders, that agreement simply establishes whose experts were relied upon by GHR's lenders. While the evidence shows that NL Industries may have relied upon the GHR lenders experts as opposed to its own, there is no evidence that NL Industries was discouraged from consulting with its own experts or tricked into relying upon the experts of the GHR lenders. The Court concludes that no misrepresentation was made by Holditch to NL Industries.

Summary judgment is granted as to NL Industries' misrepresentations claim.

The Court turns now to NL Industries' assertions of negligence and gross negligence on the part of Holditch in designing the production enhancement procedures and what appears inferentially to be a third-party beneficiary claim.

In order for NL Industries to ward off Holditch's motion for summary judgment, assuming Holditch's motion is *prima facie* meritorious, NL Industries must persuade the Court that a genuine issue of material fact exists. In common law negligence, the plaintiff must establish that a legal duty exist. *Bean* v. *Entex*, 744 S.W.2d 323 (Tex. App. — Houston [1st Dist.] 1988, no writ).

At the outset, NL Industries' allegation that Holditch designed the production enhancement procedure is without foundation. The unrefuted evidence shows and the contract between Holditch and GHR called for Holditch to review and approve GHR's design. All the evidence shows that GHR designed the fracture stimulation procedure consistent with the Holditch Model. As stated earlier, the difference between the Holditch Model and the GHR Method is the size of the fracture treatment, *i.e.*, fracture length of 1500 feet as opposed to 1000 feet and use of 12 lbs/gal. of propant as opposed to 8 lb/gal. of propant.

No legal duty was breached, as Holditch had no duty to NL Industries.

The next question is what duty, if any, did Holditch owe to NL Industries as a third-party beneficiary not privy to the contract between Holditch and GHR. Stated differently, did Holditch owe a duty to NL Industries to state that the production enhancement procedure did not conform to the 55 Well "Recent Workover Performance Wells." All of the evidence shows that the production enhancement procedure did conform to the high concentration treatment method contracted for. There existed two sets of data, one set on the more conservative approach, the Pre-1984 Method, and one set on the expanded approach, the 300 plus Well data approved by Holditch. Taken together, the evidence shows that the GHR procedure was successful and productive. NL Industries has produced no evidence that the data relied upon was faulty or false. The fact that the results were not identical to those experienced in the 55 Well-Recent Workover Performance, is not evidence of fraud, breach of duty or misrepresentation.

It is undisputed that Holditch was not a party to the NL Industries/GHR contract. Likewise, it is undisputed that NL Industries was not a party to the GHR/Holditch contract.

While the language in the NL Industries/GHR contract was binding upon each of the parties, no obligation, implied or in fact, existed on the part of Holditch. Article 4.1(c) expresses the parties agreement that Holditch will be required to perform certain duties under the workover agreement. The agreement does not obligate Holditch to do any act for which Holditch is now accountable. Section 4.1(c) of the contract provides that:

> The designation of all other Wells, as subject Wells for which Production Enhancement Procedures are to be performed hereunder shall be subject to the mutual agreement of S.A. Holditch and Associates ("Holditch"), B.P. Huddleston & Co., Inc. ("Huddleston"), and Netherland and Sewell and Associates ("Netherland Sewell") who, prior to commencement of Production Enhancement Procedures for a Subject Well, shall jointly certify to the Banks that . . . .

This language is preceded by other language to the effect that prior consent of GHR's lenders was required before certain Wells were designated for production enhancement procedures. Clearly, if Holditch was responsible to anyone other than GHR, it was to the GHR lenders, the true third-party beneficiaries of the NL Industries/GHR agreement.

After reviewing the NL Industries/GHR contract and related documents, the Court concludes that the procedure was not at the direction of NL Industries but that of the GHR lenders whose consent was a condition precedent to designation of the Wells for the production enhancement procedures. Even if Holditch were negligent, the fact that Holditch owed no legal duty to NL Industries and only rendered an opinion based on its best judgment does not bring Holditch within NL Industries' reach. See *San Antonio* v. *McKenzie Construction Co.*, 136 Tex. 315, 150 S.W.2d

989 (1941). Something more than simple negligence is required.

Finally, a word is necessary concerning NL Industries' assertion that Holditch's conduct was capricious, arbitrary, or fraudulent. Such conduct, to be actionable, must amount to bad faith and a failure to use honest judgment. To overcome Holditch's proffered opinions, NL Industries must show more than that another engineer has a different opinion, *City of San Antonio*, 150 S.W.2d at 996, but that the opinion is fatally flawed based on bad faith or dishonest judgment. There is absolutely no evidence that approaches this level. All of the Holditch estimates on the benefit of the restimulation procedure were based on data supplied by GHR. In addition, the data on the Wilcox (Lobo) Trend generally indicated that the larger the fracture treatment size, the larger the drainage area, thus, a greater return on gas. Finally, Holditch's own economics dictated longer fracture when the price of gas is flat or deescalating. No evidence was offered by NL Industries to refute these material facts.

Summary judgment is therefore appropriate on the negligence, gross negligence, and third-party beneficiary claims.

It is ORDERED that Holditch's motion for summary judgment be, and same is GRANTED.

SIGNED this 31st day of January, 1990.

/s/
KENNETH M. HOYT
United States District Judge

## APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| NL INDUSTRIES, INC., | § | |
| *Plaintiff,* | § | |
| VS. | § | |
| GHR ENERGY CORPORATION | § | CIVIL ACTION |
| AND SOUTHERN STATES, | § | NO. H-86-3334 |
| EXPLORATION INC. | § | |
| AND S.A. HOLDITCH | § | |
| ASSOCIATES, | § | |
| *Defendants.* | § | |

## FINAL JUDGMENT

Because the Court has concluded that the defendant's, S.A. Holditch Associates, motion for summary judgment is meritorious and has granted it, the plaintiff, NL Industries, Inc., is entitled to a take-nothing as a result of this suit.

ORDERED that NL Industries, Inc. take-nothing by their suit.

This is a FINAL JUDGMENT.

SIGNED this 31st day of January, 1990.

/s/
KENNETH M. HOYT
United States District Judge

APPENDIX F

IN THE

# United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 90-2235

N L INDUSTRIES, INC.,

*Plaintiff-Appellant,*

VS.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC., AND
S.A. HOLDITCH & ASSOCIATES, INC.,

*Defendants-Appellees.*

Appeal from the United States District Court for the Southern District of Texas

**ON PETITIONS FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC**

(Opinion 6/3/91, 5 Cir., 199.., ..... F.2d .....)

(July 5, 1991)

Before THORNBERRY, JOLLY and SMITH, Circuit Judges.

PER CURIAM:

(X) The Petitions for Rehearing are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestion for Rehearing En Banc is DENIED.

( ) The Petitions for Rehearing are DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ HOMER THORNBERRY
United States Circuit Judge

# APPENDIX G
## EXCERPTS FROM DISCLOSURE STATEMENT TO AMENDED AND RESTATED NEGOTIATED CHAPTER 11 PLAN PURSUANT TO SECTION 1125 OF THE BANKRUPTCY CODE

(a) Class 1. Allowed Priority Claims Plus Allowed Administrative Expenses. Allowed Priority Claims and Allowed Administrative Expenses (other than Trade Administrative Expenses) are to be paid in cash, when due but not earlier than the Consummation Date....
(p. 145)

* * *

If any unliquidated disputed Administrative Expense or unliquidated Disputed Claim is subsequently allowed, the Holder shall be entitled to receive the "Make-Up Amount, representing the total amount of distributions the Holder of such Claim or expense would have received if such Claim had been allowed as of confirmation.
(p. 193)

* * *

(g) NL Industries, Inc. v. GHR Energy Corp. and Southern States Exploration, Inc.; C.A. H-86-3334; In the United States District Court for the Southern District of Texas, Houston Division, removed to and now pending under Adversary Proceeding No. 86-0864; In the United States Bankruptcy Court for the Southern District of Texas, Houston Division. On or about August 27, 1986, NL Industries, Inc. filed a Complaint in the United States District Court for the Southern District of Texas, Houston Division seeking recovery of approximately $16 million in actual damages, plus punitive damages of three times their actual damages and attorneys' fees,.... NL also filed a priority Proof of Claim in the Chapter 11 Proceedings of TANG and SS Exploration asserting identical grounds as alleged in the Federal Court Complaint.
(pp. 372-373)

# APPENDIX H

## EXCERPTS FROM FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER CONFIRMING DEBTORS' AMENDED AND RESTATED NEGOTIATED CHAPTER 11 PLAN

* * *

Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the Plan provides that:

(i) with respect to a claim of a kind specified in 11 U.S.C. Sections 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5) or 507(a)(6) on the effective date of the Plan (which, pursuant to Section 12.02 of the Plan, is the Consummation Date), the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(P.6)

* * *

The evidence submitted on unresolved disputed administrative claims, including the administrative claims of NL Industries, Inc. . . . and the evidence of the Debtor's ability to satisfy any or all such claims if Debtors should subsequently be determined to be liable therefor, show that these unresolved disputed administrative claims do not impact upon the feasibility of the Plan.

(P.7)

* * *

18. This Court shall retain jurisdiction pursuant to and for the purpose set forth in 11 U.S.C. Sections 1112, 1127, and 1142 and Article XI of the Plan.

(P.13)

# APPENDIX I

## EXCERPTS FROM AMENDED AND RESTATED NEGOTIATED CHAPTER 11 PLAN

3.01 Administrative Expenses and Class 1 Claims.

(a) Class 1 Claims are not impaired under the Plan. Each Holder of an Allowed Administrative Expense (other than a Trade Administrative Expense) or a Class 1 Claim shall be paid the full amount of such expense or Claim when due (but not earlier than the Consummation Date) except to the extent the Bankruptcy Court orders otherwise (but in no event shall any such payments be made prior to the Cash-Out Date).

(P. 6-7)

* * *

(iii) If any unliquidated Disputed Administrative Expense is allowed or an unliquidated Disputed Claim is allowed as a Class 1 Claim, then the Holder of such administrative expense or Claim shall receive a payment or payments equal in the aggregate to the allowed amount of such administrative expense or Claim with interest accrued thereon at the Adjusted T-Bill Rate from the Consummation Date to the date of payment.

(P. 53)

* * *

## ARTICLE XI

### RETENTION OF JURISDICTION

11.01 General Retention. The Bankruptcy Court shall retain jurisdiction of these Bankruptcy Cases pursuant to and for the purposes set forth in Bankruptcy Code §§ 1112, 1127 and 1142 and to:

(a) determine the allowance or disallowance of Claims and Interests and, without limiting the foregoing, to determine the amount (and any Undisputed Amount) of all or part of any Claim against any Debtor or GHR Parent;

(b) fix allowances of compensation and other administrative expenses;

(P. 187-188)

* * *

(f) resolve any disputes or litigation arising under the Plan or Ancillary Documents . . . provided, further, that the Bankruptcy Court shall retain exclusive jurisdiction over the matters enumerated in this paragraph (f) and no Debtor, Obligee, Holder, Indemnified Fiduciary, Indemnified Creditor, Bank Agent or other Person shall attempt to resolve any such dispute or bring any such litigation in any forum other than the Bankruptcy Court;

(P. 188-189)

* * *

# APPENDIX J

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

*28 U.S.C. § 959(b)* provides:

**§ 959. Trustees and receivers suable; management; State laws**

(b) Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

(As amended Nov. 6, 1978, Pub.L. 95-598, Title II, § 235, 92 Stat. 2667.)

*11 U.S.C. § 503(b)(1)(A)* provides:

(b) After notice and a hearing, there shall be allowed, administrative expenses, other than the claims allowed under section 502(f) of this title, including —

> (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case;

*11 U.S.C. 507(a)(1)* provides:

(a) The following expenses and claims have priority in the following order:

> (1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

*11 U.S.C. § 1129(a)(9)(A)* provides:

(a) The court shall confirm a plan only if all of the following requirements are met:

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that —

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

*11 U.S.C. § 1141(d)(1)(A)* provides:

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan —

(A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title, whether or not —

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan;

*U.S. Const. amend. V* provides:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the

same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

* * *

*28 U.S.C. § 157* provides:

**28 U.S.C. § 157. Procedures**

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

(2) Core proceedings include, but are not limited to —

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11, but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

* * *

(I) determinations as to the dischargeability of particular debts;

* * *

(L) confirmations of plans;

* * *

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

* * *

(d) The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

(Added Pub. L. 98-353, Title I, § 104(a), July 10, 1984, 98 Stat. 340, and amended Pub.L. 99-554, Title I, §§ 143, 144(b), Oct. 27, 1986, 100 Stat. 3096.)

*28 U.S.C. § 158*

**§ 158. Appeals**

(a) The district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees, and, with leave of the court, from interlocutory orders and decrees, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving.

(b)(1) The judicial council of a circuit may establish a bankruptcy appellate panel, comprised of bankruptcy judges from districts within the circuit, to hear and determine, upon the consent of all the parties, appeals under subsection (a) of this section.

* * *

(c) An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules.

(d) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.

(Added Pub.L. 98-353, Title I, § 104(a), July 10, 1984, 98 Stat. 341, and amended Pub.L. 101-650, Title III, § 305, Dec. 1, 1990, 104 Stat. 5105.)

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NO. 91-722

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1991

NL INDUSTRIES, INC.,
*Petitioner,*

v.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC.,
and S.A. HOLDITCH & ASSOCIATES, INC.,
*Respondents.*

## S. A. Holditch & Associates, Inc.'s Brief in Opposition to NL Industries, Inc.'s Petition for Writ of Certiorari to The United States Court of Appeals for The Fifth Circuit

## BRIEF IN OPPOSITION FOR RESPONDENT

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## LIST OF PARTIES

The parties to the proceedings below were petitioner NL Industries, Inc. and respondents GHR Energy Corporation, Southern States Exploration, Inc. and S. A. Holditch & Associates, Inc.

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NO. 91-722

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1991

NL INDUSTRIES, INC.,
*Petitioner,*

v.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC.,
and S.A. HOLDITCH & ASSOCIATES, INC.,
*Respondents.*

## BRIEF IN OPPOSITION FOR RESPONDENT

**S. A. Holditch & Associates, Inc.'s Brief in Opposition to NL Industries, Inc.'s Petition for Writ of Certiorari to The United States Court of Appeals for The Fifth Circuit**

Respondent S.A. Holditch & Associates, Inc., files this Brief in Opposition to NL Industries, Inc.'s Petition for Writ of Certiorari to urge that the writ, as to Issue III, not be granted because the judgment of the Fifth Circuit Court of Appeals on this issue is correct.

## OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 940 F.2d 957 and is reprinted in petitioner's appendix A. The opnions of the United States District Court for the

Southern Texas, Houston Division have not been reported and are reprinted in petitioner's appendices B and D.

## JURISDICTION

Jurisdiction of this Court to review the judgment of the Fifth Circuit is invoked under 28 U.S.C. § 1254(1).

By order of June 3, 1991, the Fifth Circuit affirmed in part and reversed in part the judgment of the district court and remanded for further proceedings. 932 F.2d 422. On June 17, 1991, NL Industries, Inc., filed a petition for rehearing and a suggestion for rehearing en banc. By unreported order of July 5, 1991, reprinted in petitioner's appendix F, both were denied. The Fifth Circuit then issued a corrected opinion on July 26, 1991. 934 F.2d 580. On September 10, 1991, the Fifth Circuit withdrew its corrected opinion and issued a third opinion. 940 F.2d 957. On November 1, 1991, NL Industries, Inc., filed a Petition for Writ of Certiorari pursuant to Sup. Ct. R. 13.2. This Brief in Opposition to the Petition for Writ of Certiorari is timely filed pursuant to Sup. Ct. R. 15.

## STATEMENT OF THE CASE

Petitioner NL Industries, Inc., ("NL"), an oilfield supply and service company, and GHR Energy Corp. and Southern States Exploration, Inc., ("GHR"), an oil and gas producer, entered into an agreement dated April 9, 1985 (the "NL-GHR contract") under which NL agreed to perform certain workover and production enhancement procedures on a group of ten natural gas wells owned by GHR. (R.E. 182). At the request of GHR's secured bank lenders (the "Bank Group"), the NL- GHR

contract contained a provision requiring three engineering companies, including S.A. Holditch & Associates, Inc. ("Holditch"), jointly to certify to the Bank Group that the production enhancement procedures would increase the present value of the futue net revenues realized from the wells by more than the anticipated costs of the production enhancement procedures. (R.E. 189). Holditch is a professional engineering company that engages in petroleum engineering consulting services. Neither Holditch, nor the other two engineers, was a party to the NL-GHR contract. Also, none of these engineers certified, jointly or individually, to the Bank Group or to NL that the revenues from the workovers would exceed anticipated costs.

Article 4.3.i.1 of the NL-GHR contract provided that Holditch was to review and approve or, in its sole discretion, modify the fracture stimulation procedures proposed by GHR. In their contract, NL and GHR agreed that Holditch was to be the final and ultimate arbiter on the fracture stimulation procedures.[1] Specifically, the NL-GHR contract provided that "GHR and [NL] understand and agree that all decisions or modifications by Holditch of or with respect to any proposed fracture or other formation stimulation program submitted by GHR pursuant thereto shall be final and binding" upon NL and GHR. (R.E. 206-07). Holding that under Texas law, Hol-

1. Fracturing is a method of increasing the production of gas wells by injecting a propping agent, such as sand, into the formation from which the well produces under pressure in order to increase the permeability of the rock and thereby allow an increased flow of hydrocarbons. "Fracturing" is a "process of opening up underground channels in hydrocarbon-bearing formations, by force, rather than by a chemical action such as acidizing." *See* 8 H. Williams & C. Meyers, *Oil and Gas Law* 379 (1987).

ditch was an arbiter under the NL-GHR contract, the district court granted and summary judgment in favor of Holditch on the ground that Holditch's status as an arbiter precluded liability under the negligence theories asserted by petitioner in its First Amended Complaint. The Fifth Circuit affirmed.

## REASONS FOR DENYING THE WRIT

### I. Petitioner May Not Assert New Theories or New Issues on Appeal.

In its Petition for Writ of Certiorari, petitioner asserts for the first time that the opinions below, holding that it could not recover from Holditch for negligence because the NL-GHR contract designated Holditch as an arbiter, are in direct conflict with this Court's decision in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 147-48 (1968) (NL's Petition, Issue III, p. 18-19).

In section II, *supra*, Holditch will demonstrate that the *Commonwealth Coatings* rule cannot apply to Holditch. However, notwithstanding the inapplicability of this rule, petitioner's argument is untimely. Petitioner may not oppose summary judgment on appeal with new theories, new evidence, or new materials that were not presented to the trial court. *Savers Fed. Sav. & Loan Ass'n v. Reetz*, 888 F.2d 1497, 1501 (5th Cir. 1989); *John v. State of La. (Board of Trustees for State Colleges and Universities)*, 757 F.2d 698, 703, 710-11 (5th Cir. 1985); *Kriegesmann v. Barry-Wehmiller Co.*, 739 F.2 357, 358 (8th Cir.), *cert. denied*, 469 U.S. 1036 (1984). Petitioner did not raise this argument in the trial court, and in fact, petitioner's Reply Brief in the Fifth Circuit is the

first instance in which the petitioner even intimates the existence of this issue. NL's Reply Brief at 9.

An appellate court is constrained by the same standards as the trial court in reviewing a motion for summary judgment; that is, the appellate court must also "draw inferences most favorable to the party opposing the motion, and take care that no party will be improperly deprived of a trial of disputed factual issues." *John,* 757 F.2d at 708 (citing *United States Steel Corp. v. Darby,* 516 F.2d 961, 963 (5th Cir. 1975)). The party opposing summary judgment "must inform the trial judge of the reasons, legal or factual, why summary judgment should not be entered. If it does not do so, and loses the motion, it cannot raise such reasons on appeal." *Liberles v. County of Cook,* 709 F.2d 1122, 1126 (7th Cir. 1983). Recently, in *Celotex Corp. v. Catrett,* 477 U.S. 317 (1986), this Court affirmed the rule that in a summary judgment proceeding the nonmovant must timely assert all arguments in the trial court, stating that there is no "express or implied requirement in Rule 56 that the moving party support its motion with affidavits or other similar materials negating the opponent's claim." *Id.* at 323. This Court places an affirmative duty on the nonmovant, petitioner here, to present any arguments or evidence that raises a genuine issue of a material fact which would defeat the entry of summary judgment in the trial court once the movant has met its burden of showing an absence of a genuine issue of material fact. *Id.* Although Petitioner filed affidavits concerning statements to this effect, it did not raise in the trial court its contention that its lack of knowledge of the prior business dealings between GHR and Holditch was a genuine issue of material fact which would bar entry of summary judgment

in favor of Holditch. Thus, petitioner is precluded from raising this argument for the first time in this Court.

The appellate court also must "examine the record as it existed at the time summary judgment was granted, without regard to facts or allegations not submitted to the trial court's scrutiny." *Penton v. Crown Zellerbach Corp.*, 699 F.2d 737, 741 (5th Cir. 1983). Although the meaning of "submitted to the trial court's scrutiny" was a previously disputed standard in the Fifth Circuit, in *Nissho-Iwai American Corp. v. Kline*, 845 F.2d 1300, 1307 (5th Cir. 1988) the Fifth Circuit definitively asserted that the trial court is not compelled to search the entire record for any semblance of a genuine issue of material fact before entering summary judgment. *Nissho-Iwai American Corp. v. Kline*, (cited with approval in *Savers Fed. Sav. & Loan Ass'n v. Reetz*, 888 F.2d 1497, 1501 (5th Cir. 1989))[2] Although neither of these cases expressly overruled *Higgenbotham v. Ochsner Found. Hosp.*, 607 F.2d 653, 656-57 ((5th Cir. 1979), and its progeny *(e.g. Nicholas Acoustics & Specialty Co. v. H & M Constr. Co.*, 695 F.2d 839, 845-47 (5th Cir. 1983) and *John*, 757 F.2d at 711), the trend in the Fifth Circuit and in other circuits is to require a trial court to base its rulng on a motion for summary judgment only on those matters specifically brought to the attention of the court. *Cookish v. Cunningham*, 787 F.2d

2. The Fifth Circuit previously held in *Higgenbotham v. Ochsner Found. Hosp.*, 607 F.2d 653, 656-57 (5th Cir. 1979), that where the record is not voluminous, the district court must consider the record as a whole, not simply those portions of the record relied upon by the moving party or specifically pointed out in opposition to the motion by the nonmoving party. However, as noted by the Fifth Circuit in *John*, the docket sheet in *Higgenbotham* showed that only five depositions were filed with the court. *John*, 757 F.2d at 711-12.

1, 6 (1st Cir. 1986) (holding that "an issue raised in the pleadings only was not 'presented' to the trial court, and cannot be argued on appeal"); *Beaudett v. City of Hampton*, 775 F.2d 1274, 1278 (4th Cir. 1985), *cert. denied*, 475 U.S. 1088 (1986); *Libertyville Datsun Sales, Inc. v. Nissan Motor Corp.*, 776 F.2d 735, 737 (7th Cir. 1985) (finding that it was the party's responsibility to "raise the *arguments* that it seeks to use . . . on appeal") (emphasis in original); *In re E. R. Fegert, Inc.*, 887 F.2d 955, 957 (9th Cir. 1989) (holding that the standard for whether an appellate court may consider an issue turns on whether the argument was "raised sufficiently for the trial court to rule on it"); *Cavic v. Pioneer Astro Indus., Inc.*, 825 F.2d 1421, 1425 (10th Cir. 1987) (holding that an appellate court could not consider an issue which was raised in the answer but not considered or ruled on by the district court); *In Re Pan American World Airways, Inc.*, 905 F.2d 1457, 1462 (11th Cir. 1990) (corollary of the rule that new issues may not be raised on appeal is that an issue must be clearly presented to the district court "in such a way as to afford the district court an opportunity to *recognize and rule on it*") (emphasis added).

The *Nicholas Acoustics* court also distinguished those cases in which the nonmovant raised "a distinct issue for the first time on appeal or introduced new material into the record on appeal" from cases in which the nonmovant failed "to point out to the district court support already in the record for the position that an issue is actually shown by the record to be in dispute." *Nicholas Acoustics*, 695 F.2d at 846 n. 7. Because petitioner never argued to the trial court that the prior business dealings between

GHR and Holditch were undisclosed and that this non-disclosure somehow harmed petitioner, petitioner is now foreclosed from attempting to raise that issue on appeal.

The *John* and *Nicholas Acoustics* courts also distinguished cases in which the record is relatively small from cases in which the record is voluminous and the evidence which purportedly demonstrates a disputed issue of material fact can be characterized "a needle in a paper haystack." *John*, 757 F.2d at 711; *Nicholas Acoustics*, 695 F.2d at 846-47 (examining the small record but noting that "it is foolhardy for counsel to rely on a court to find disputed issues of material fact not highlighted by counsel's paperwork" and that "practical constraints on the time of a judge make it impossible for the judge to examine a record of even moderate size"). *See also Local Union No. 59 v. Namco Electric, Inc.*, 653 F.2d 143, 146 (5th Cir. Unit A Aug. 1981) (holding that the appellate court can only review those "exhibits, depositions, and affidavits that were presented to, *and considered by*, the trial court") (emphasis added). As petitioner admitted in its Memorandum in Support of Motion for Leave to File Second Amended Complaint, this record is clearly voluminous and unwieldy. (R.E. 157-65). The record here is in excess of 1,000 pages, petitioner presented only two sentences in two separate affidavits alleging that it had no knowledge of the relationship between Holditch and GHR. Thus, even under the *Higgenbotham* reasoning, the trial court in this case was not presented with, and could not have considered, the issue whether summary judgment was precluded because of the prior business relationship between GHR and Holditch. More importantly, NL did not allege in its pleadings or argue in the trial court that such non-

disclosure constituted bad faith so as to warrant invalidation of Holditch's decisions as an arbiter. Therefore, thiis new argument is untimely.

## II. The Fifth Circuit's Opinion is not in Conflict With Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145 (1968).

Petitioner argues that the opinions below which held that it could not recover from Holditch for negligence because the NL-GHR contract designated Holditch as an arbiter are in direct conflict with this Court's decision in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 147-48 (1968) (NL's Petition, Issue III, p. 18-19). Petitioner is wrong.

In *Commonwealth Coatings,* this Court applied the United States Arbitration Act and set aside an arbitration award on the ground that the third "neutral" arbitrator did not disclose his prior business relationship with one of the parties. *Commonwealth Coatings,* 393 U.S. at 147-50 (citing the United States Arbitration Act, 9 U. S.C. § 10, which delineates the grounds for vacating an arbitral award and § 18 of the Rules of the American Arbitration Association which requires disclosure by the arbitrator of "any circumstances likely to create a presumption of bias or which he believes might disqualify him as an impartial Arbitrator"). *Commonwealth Coatings* is clearly inapplicable here for three reasons. First, neither the United States Arbitration Act nor the Rules of the American Arbitration Association apply to this case. Petitioner and GHR did not arbitrate their disputes pursuant to the general arbitration clause in Article 6.7 of the NL-GHR contract. Additionally, Holditch is an

arbiter under the NL-GHR contract, not an arbitrator; thus, the provisions of the federal arbitration statute do not govern these facts. Second, the rule of *Commonwealth Coatings* requiring arbitrators to disclose "any dealings that might create an impression of possible bias" is by its terms applicable to arbitrators. However, decisions of arbiters such as Holditch are given effect in the absence of a clear and uncontroverted showing of bad faith, fraud, or failure to exercise an honest judgment. *United States v. Moorman,* 338 U.S. 457 (1950); *Cities Serv. Co., Inc. v. Derby & Co., Inc.*, 654 F. Supp. 492, 500 (S.D.N.Y.), *aff'd*, 835 F.2d 1429 (2d Cir. 1987); *City of San Antonio v. McKenzie Constr. Co.*, 150 S.W.2d 989, 996 (Tex. 1941); *see also, Huey v. Davis,* 556 S.W.2d 860, 864 (Tex. Civ. App.—Austin, 1977, writ ref'd n.r.e.) (contract regarding painting a 1978) (provision regarding performance of contract for the construction of residential dwelling); *Austin Bridge Co. v. State,* 550 S.W.2d 135, (Tex. Civ. App.—Waco 1977, writ ref'd nflrflefl) (contract regarding painting a bridge); *Plantation Foods, Inc. v. R.J. Reagan Co.*, 520 S.W.2d 432, 434-35 (Tex. Civ. App.—Waco 1975, writ ref'd n.r.e.) (agreement allowing architect to determine cause of roof problems); *Hooks v. Cook,* 345 S.W. 2d 592, 594-95 (Tex. Civ. App.—Houston 1961, writ ref'd n.r.e.) (agreement to be bound by surveyor's determination of acreage); *Goodrum v. State,* 158 S.W.2d 81, 86-87 (Tex. Civ. App.—Galveston 1942, writ ref'd w.o.m.) (provision making architect the judge of proper performance of contract). Even assuming that the prior business relationship between GHR and Holditch was unknown to Petitioner at the- time it entered into the NL-GHR contract with GHR, the *Commonwealth Coat-*

*ings rule* does not apply to Holditch in his role as an arbiter. In affirming summary judgment in favor of Holditch, the Fifth Circuit unequivocally held that Petitioner could not prove bad faith or egregious misconduct on the part of Holditch as its complaint merely alleged a negligence cause of action against Holditch. Third, unlike the facts of this case, petitioner in *Commonwealth Coatings* challenged the arbitration award on this ground in the district court. NL failed to bring this issue to the attention of the district court.

GHR filed a moion to compel arbitration pursuant to Article 6.7 of the NL-GHR contract. (R. 490). NL opposed this motion. However, the district court did not order arbitration and the parties litigated their disputes in federal court; therefore, the provisions of the United States Arbitration Act and the holding of *Commonwealth Coatings* are completely inapplicable to this case. Even if NL and GHR had submitted their disputes to arbitration in accordance with the NL-GHR contract, Holditch would merely have been an arbiter, and not an arbitrator. Thus, any potential bias within the meaning of *Commonwealth Coatings* which NL now argues Holditch might have by virtue of its prior business dealings with GHR is wholly irrelevant.

Arbitration is both contractural and consensual. *Peerless Importers, Inc. v. Wine, Liquor & Distillery Workers Union Local One,* 903 F.2d 924, 927 (2d Cir. 1990) (citing *AT & T Technologies, Inc. v. Communications Workers of Am.,* 475 U.S. 643, 648 (1986)); *Neal v. Hardee's Food Sys., Inc.,* 918 F.2d 34, 37 (5th Cir. 1990); *United Paperworkers Int'l Union v. Int'l Paper Co.,* 920 F.2d 852, 855 (11th Cir. 1991). The task

of an arbitrator is contract interpretation. *Lancaster v. Norfolk & Western Ry. Co.*, 773 F.2d 807, 814 (7th Cir. 1985), *cert. denied*, 480 U.S. 945 (1987) (citing *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 597 (1960)). In contrast, an engineer or architect who issues a certificate of compliance under a contract performs a much more narrow function. Engineers and architects are not typically expressly designated as arbitrators charged with the task of contractual interpretation; rather, their decisions are generally only binding with respect to compliance with specifications, materials, and artistic effects under the contract. *United Pacific Ins. Co. v. County of Flathead*, 499 F.2d 1235, 1237 (9th Cir. 1974) (decisions of architects or engineers regarding performance of contractual specifications are binding in the absence of fraud or bad faith); *Marceron v. Chevy Chase Services, Inc.*, 258 F.2d 155, 158 (D.C. Cir. 1958) (distinguishing the function of appraisers (fixing fair market value) from the function of arbitrators (private judges with contractual powers)); *John W. Johnson, Inc., v. J. A. Jones Constr. Co.*, 369 F. Supp. 484, 489 (E.D. Va. 1973). These engineers and architects are generally known as contractually-designated arbiters. Holditch is an arbiter rather than an arbitrator under the NL-GHR contract.

NL and GHR expressly agreed in Article 6.7, the arbitration clause, of the NL-GHR contract that "[a]ny controversy or claim arising out of or relating to this contract, or the breach thereof" would be settled by arbitration "in accordance with the Commercial Arbitration Rules of the American Arbitration Association." Even NL acknowledges in its Fifth Circuit brief that only a narrow reading of Article 4.3.i.1 (providing for Holditch

to review and modify GHR's frac designs) "confining 'finality' to questions of pre-workover design, can be harmonized with the presence of the general arbitration clause." Petitioner's Brief for the Fifth Circuit at 31. NL and GHR clearly did not intend to and did not designate Holditch as an arbitrator under the NL-GHR contract. Holditch's duties under the NL-GHR contract were limited to reviewing and approving or modifying the proposed fracture designs. Holditch's decisions or modifications *"of or with respect to any proposed fracture or other formation stimulation program submitted by GHR"* are *"final and binding upon the Parties."* NL-GHR contract, Article 4.3.i.l. (emphasis added). Thus, Holditch's limited duties imposed upon it under the NL-GHR contract did not in any way encompass contractual interpretation, the province of an arbitrator pursuant to the Article 6.7 arbitration clause.

In *Federated Dep't. Stores, Inc. v. J.V.B. Indus.*, 894 F.2d 862, 867 (6th Cir. 1990), the court reconciled similar provisions in a construction contract by ruling that the architects could only resolve discrepancies, inconsistencies and conflicts with respect to his own drawings and specifications prepared in accordance with the contract. The court held that the arbitrators' decision that the architect could only resolve discrepancies relating to artistic effects was "inescapable in light of the broad arbitration clause in the contracts, which subjects all claims arising out of the contract to arbitration." *Id.* Thus, because the broad arbitration clause in Article 6.7 of the NL-GHR contract also stipulates that disputes and claims arising out of the contract should be submitted to arbitration, Holditch's role is clearly limited to that of a contractually-designated arbiter whose decisions are only bind-

ing with respect to the factual task of reviewing and modifying the designs of the production enhancement procedures.

Because Holditch is an arbiter as opposed to an arbitrator, *Commonwealth Coatings* does not dictate that Holditch's decisions under the NL-GHR contract be set aside on the ground that Holditch and/or GHR failed to disclose their ongoing business relationship to NL. *See Fuller v. Highway Truck Drivers and Helpers Local 107*, 428 F.2d 503, 508 (3d Cir. 1970) (distinguishing *Commonwealth Coatings* from a union committee decision in that *Commonwealth Coatings* involved an "arbitrator whose activities and relationships gave rise to the impression of bias . . . [and who] was in a position to directly influence the decision by participating in the deliberations of the arbitrating panel and by casting his vote").

Further, the scope of the *Commonwealth Coatings* rule as applied to true arbitrators has been criticized and circumscribed by various courts. *Toyota of Berkley v. Automobile Salesman's Union, Local 1095*, 834 F.2d 751, 755 (9th Cir. 1987), *cert. denied*, 486 U.S. 1043 (1988) (adopting Justice White's concurrence in *Commonwealth Coatings* that arbitrators, "who are often effective because of their connections to the marketplace, should not be disqualified automatically by a business relationship with the parties if it is fully disclosed or trivial"); *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 681-82 (7th Cir.), *cert. denied*, 464 U.S. 1009 (1983) (noting that *Commonwealth Coatings* was not a clear majority decision and citing Justice White's concurrence for the proposition that arbitrators are not held

to the same ethical standards as Article III judges); *Ormsbee Dev. Co. v. Grace,* 668 F.2d 1140, 1150 (10th Cir.), *cert. denied,* 459 U.S. 838 (1982) (holding that evidence of impropriety on the part of an arbitrator must be "direct, definite, and capable of demonstration"); *Cook Indus., Inc. v. Itoh & Co. (America) Inc.,* 449 F.2d 106, 108 (2d Cir. 1971), *cert. denied,* 405 U.S. 921 (1972) (holding that the duty of arbitrators to disclose a pecuniary interest is limited to disclosure of "dealings of which the parties cannot reasonably be expected to be aware, i.e., dealings 'not in the ordinary course of . . . business' "). *Commonwealth Coatings* is simply inapplicable to this case and is not a proper basis for the granting of the Petition for Writ of Certiorari.

## CONCLUSION

For the foregoing reasons, S.A. Holditch & Associates, Inc. respectfully requests that the Court deny the Petition for Writ of Certiorari as to Issue III.

Respectfully submitted,

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No. 91-722

IN THE

*Supreme Court of The United States*

OCTOBER TERM, 1991

NL INDUSTRIES, INC.

*Petitioner,*

V.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC.
AND S.A. HOLDITCH & ASSOCIATES, INC.,

*Respondents.*

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT**

**BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI**

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**BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI**

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## RULE 29.1 LISTING

GHR Energy Corporation, n/k/a TransAmerican Natural Gas Corporation is the parent corporation. Southern States Exploration, Inc. is a wholly owned subsidiary of TransAmerican Natural Gas Corporation. Other than their wholly owned subsidiaries, neither TransAmerican Natural Gas Corporation nor Southern States Exploration, Inc. has any subsidiaries.

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IN THE

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NL INDUSTRIES, INC.

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V.

GHR ENERGY CORPORATION,
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*Respondents.*

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**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT**

---

**BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT**

---

Respondents GHR Energy Corporation, Southern States Exploration, Inc. respectfully pray that the Court deny the Petition for Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered on September 10, 1991.

## SUMMARY OF ARGUMENT

NL asserts that the Fifth Circuit's holding that punitive damages are not recoverable as an administrative expense conflicts with decisions of this Court and a number of other circuits. The cases upon which NL relies, however, stand only for the proposition that actual compensatory damages in tort are recoverable as administrative expenses. The cited decisions do not support the proposition that punitive damages are recoverable as administrative expenses. On the contrary, a number of trial and appellate courts have held that punitive damages, unlike compensatory actual damages in tort, are not recoverable as administrative expenses in bankruptcy.

Following NL's original complaint, TransAmerican removed this action to the bankruptcy court. On NL's own motion, the reference of this matter was withdrawn and the case transferred back to the district court. The district court exercised jurisdiction over this matter pursuant to 28 U.S.C. §1334 and properly addressed NL's entitlement to punitive damages in bankruptcy. The Fifth Circuit's *de novo* determination properly addressed NL's entitlement to punitive damages.

NL's original and first amended complaints assert negligence on a part of both S.A. Holditch & Associates, Inc. and TransAmerican in Holditch's activities as an arbiter. Texas law, however, holds that an arbiter's decision is final and not subject to a negligence attack, but only actions for fraud, misconduct and gross mistake. NL's attempts to include these latter causes of action through a second amendment was denied by the district court and properly affirmed on appeal.

## ARGUMENT

### I. The Fifth Circuit's Holding Regarding Punitive Damages Neither Conflicts With Decisions of this Court, Nor Represents an Important Question of Federal Law Which Should be Addressed by This Court

The thrust of NL's argument is that the decisions and underlying policies in *Reading Co. v. Brown*, 391 U.S. 471 (1968) and *Boteler v. Ingels*, 308 U.S. 57 (1939) provide for the recovery as administrative expenses of punitive damages attendant to post-petition tort claims. NL contends that the Fifth Circuit's holding regarding punitive damages conflicts with *Reading* and *Boteler*, and with decisions from other circuits.

In *Reading*, a realty corporation filed a petition for an arrangement under Chapter XI of the old Bankruptcy Act. Respondent was appointed receiver to continue operation of the debtor's business, leasing an industrial building. During the arrangement, fire destroyed the building and spread to adjoining businesses, causing extensive, real and personal property damage. Petitioner and others filed claims in the arrangement based on negligence of the respondent.

Subsequently, the realty company was adjudicated a bankrupt under Chapter XI and the petitioners' claims became claims for administrative expenses. The question presented to this Court was "whether the negligence of a receiver administrating an estate under Chapter XI arrangement gives rise to an 'actual and necessary' cost of operating the debtor's business" 391 U.S. at 476. In concluding that the post-petition tort damages were recoverable as administrative expenses, the Court relied

heavily on the Act's statutory objective of fairness to all persons having claims against the debtor.

*Reading* does not, however, stand for the proposition that punitive damages are recoverable as an administrative expense in bankruptcy. Although the opinion is not explicit, a close reading shows that petitioner was seeking to recover its monetary losses for property damage and was not seeking the imposition of punitive damages. Specifically, the issue of recovery of punitive damages is nowhere addressed in the opinion, and is not central to the rationale. Moreover, that *Reading* addressed only recovery for direct out-of-pocket expenses brought about by a post-petition tort finds support in many of NL's cited cases. *See, e.g., In re: E.A. Nord Co., Inc.*, 78 B.R. 289 (Bankr. W.D. Wash. 1987)("The Court found that the fire resulted from the receiver's negligent operation of the business, and awarded claimants an administrative expense claim for the *property damage* arising out of these negligent acts.") (emphasis added).

NL cites the Court to a number of cases, all of which are distinguishable on their facts and none of which refer to the recovery of punitive damages as an administrative expense. In *Carter-Wallace, Inc. v. Davis-Edwards Pharmacal Corp.*, 443 F. 2d 867 (2nd Cir. 1971), the appellant court addressed the propriety of injunctive relief associated with a patent infringement case. In a brief mention, the Court cites to *Reading* for the proposition at potential tort damages are recoverable as administrative expenses. The Court never mentions punitive damages, and its brief discussion of *Reading* is nothing more than dicta. In *United States Dept. of Interior v. Elliott*, 761 F.2d 168 (4th Cir. 1985), the Fourth Circuit held that environmental penalty claims accessed against the debtor for post-petition violations of the Surface Mining Control and Reclamation Act of 1977 were recoverable as administrative expenses. A

review of the language of the act and of the Court's opinion reveals, however, that although these damage claims were denoted as penalties, they actually constitute compensatory cleanup costs incurred by the agency. Elliott does not mention and does not stand for the proposition that punitive damages are recoverable as administrative expenses.

In *In re: Charles Bank Laundry, Inc.*, 755 F.2d 200 (1st Cir. 1985) the Court held that a civil fine imposed for violation of a preliminary injunction was recoverable as an administrative expense in bankruptcy. The fine, however, did not constitute punitive or penalty damages, but was merely compensation for attorneys' fees, services and out-of-pocket expenses. This conclusion is consistent with *Reading* and the Fifth Circuit's opinion as well.

In *In re: E.A. Nord Co., supra,* the district court held that an award for fees and costs incurred by a creditor as a result of frivolous claims litigation would constitute an administrative expense claim. Again, however, this award was not punitive in nature, but constituted compensatory damages relating to attorneys' fees and direct out-of-pocket expenses incurred by the creditor.

In *In re: Dennis Ponte, Inc.*, 61 B.R. 296 (Bankr. 9th Cir. 1986), the court was primarily addressing the issue of the necessity of an evidentiary hearing where an objection to the plan of reorganization is based upon feasibility. Although one of the issues relating to that feasibility was the potential collection of post-petition tort damages from the debtor as an administrative expense, the Court neither addressed nor ruled on the propriety of recovery of punitive damages as an administrative expense.

Finally, *Kelly v. Robinson*, 479 U.S. 36 (1986), dealt with the dischargeability of criminal restitution payments in the context of a Chapter 7 liquidation proceeding. The facts in *Kelly* differ substantially from those present in this matter,

and address not whether punitive or penalty type damages are recoverable from an estate, but whether Court ordered criminal restitution is discharged by the filing of a Chapter 7 petition. Although NL suggests that *Kelly* contains policy decisions which mandate a holding other than that of the Fifth Circuit's, the Court held that this exception to discharge was depended upon the "deep conviction that federal bankruptcy courts should not invalidate the results of state criminal proceedings." *Id.* at 47.

Contrary to NL's petition, case law is replete with circumstances where recovery of punitive damages (as an administrative expense or otherwise) has been denied or enjoined. The overriding rationale for punitive expenses is to punish tortfeasors and to deter both them and others from that wrongful conduct. Recovery of punitive damages as an administrative expense would, however, result in disproportionate payments to one creditor to the detriment of others, and would represent a windfall having no relation to compensatory damages. This end result is at direct variance with the policy rationale expressed in *Reading*: That the purpose of the Code is to provide fairly for the compensation of all persons having claims against a debtor. *Accord, In re: A.H. Robins Co.*, 89 B.R. 555, 559 (E.D.Va. 1988) (disallowing punitive damages as an administrative expense); *In re: Johns-Manville Corp.*, 68 B.R. 618, 627 (Bankr. S.D.N.Y. 1986) (holding that punitive damages were not recoverable from trust fund), reversed in part on other grounds, 78 B.R. 407 (S.D.N.Y. 1987), affirmed *sub nom.*, *Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2nd Cir. 1988). *See also, In re: G.A. Corp.*, 681 F.2d 1295, 1301 (11th Cir. 1982) (disallowing claim for punitive damages); *In re: Klefstead*, 95 B.R. 622 (Bankr. W.D. Wis. 1988) (disallowing state post-petition penalties).

## II. The Fifth Circuit's Dismissal of NL's Punitive Damages Claim Does Not Deprive NL of Property Without Due Process of Law

NL's contention that the Fifth Circuit's dismissal of the punitive damage claim deprives NL of its due process rights is sophistry. NL is essentially arguing that after filing this action in district court, and moving to withdraw the reference from the bankruptcy court, neither the district court nor the Fifth Circuit had jurisdiction to address the express issues which NL asked them to address.

NL's original complaint was filed in the district court on August 27, 1986. *R. 1.* On October 2, 1986, TransAmerican removed the complaint to bankruptcy court. *R.7.* On October 27, 1986 and December 29, 1986, NL filed motions and briefs seeking to have the reference of TransAmerican's bankruptcy adversaries withdrawn and the case transferred back to the district court. *R. 8 & 12.* On May 21, 1987, the matter was transferred back to the district court, the express relief sought by NL in its motion. *R. 24.*

United States district courts have original jurisdiction over bankruptcy matters pursuant to 28 U.S.C. §1334. This jurisdiction remains the same whether it is exercised by the district court, or exercised by the bankruptcy court on referral. Since the district court had both subject matter and *impersonam* jurisdiction over NL and its claims, the district court did not improperly circumvent the bankruptcy process in denying NL's punitive damage claim. On appeal, the Fifth Circuit properly made a *de novo* determination of NL's entitlement to punitive damages as an administrative claim. There is no error in the court below.

## III. The Fifth Circuit's Holding That GHR and Holditch are Insulated From Liability For Negligence Because the Agreement Designated Holditch as an Arbiter Represents the Correct Application of Texas Law

In January 1987, NL added S.A. Holditch & Associates, Inc. as a defendant, alleging that Holditch had failed to use reasonable care in reviewing TransAmerican's fracture designs. The district court found, and the Fifth Circuit agreed, that Holditch had been unambiguously appointed as an arbiter pursuant to Article 4.3.i.1 of the Agreement and as such, could not be found liable under any theory of negligence.

Texas law provides that an arbiter's decision is final and conclusive unless it is proven that the arbiter was "guilty of fraud, misconduct, or such gross mistake as would imply bad faith or failure to exercise an honest judgment." *City of San Antonio v. McKenize Constr. Co.*, 150 S.W. 2d. 989, 996 (1941); *State v. Buckner Constr. Co.*, 704 S.W. 2d. 837, 841 (Tex. App. - Houston [14th Dist.] 1985, writ ref'd n.r.e.). The Fifth Circuit's holding is entirely consistent with these cases and, since NL failed to raise causes of action alleging fraud, misconduct or gross mistake in a timely fashion, they were not properly before the court.

## CONCLUSION

Accordingly, GHR Energy Corporation and Southern States Corporation, Inc. respectfully request that the Petition for Writ of Certiorari to the United States Court of Appeals for The Fifth Circuit be denied in all respects.

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